



REPORT

Subject:	Finnigan Briefing Book Provided to Phil Skinner, Idaho
Prepared by:	MTC Legal Staff
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INTRODUCTION

This briefing book addresses a public comment received at the Uniformity Committee's April, 2018 meeting asking the Committee to consider adding a "*Finnigan*" option in the Commission's Model Statute for Combined Reporting, which currently uses the "*Joyce*" approach.¹ It provides an executive summary of the *Joyce/Finnigan* debate and related issues and also includes appendices that provide additional background information.

In addition to the Model Statute for Combined Reporting,² adopting a *Finnigan* approach would directly affect two other MTC uniformity recommendations which follow the *Joyce* approach, at least to an extent: the Statement of Information Concerning Practices of Multistate Tax Commission and Signatory States Under Public Law 86-272;³ and the Model Factor Presence Nexus Standard for Business Activity Taxes.⁴ In addition, it may affect a provision in our model General Allocation and Apportionment Regulations.⁵

State positions have shifted since these models were adopted. The most significant reason the Commission had for adopting the *Joyce* approach was to avoid litigation. The risks that litigation may have posed have not materialized, however.

¹ The *Joyce/Finnigan* issues is so-named because of two administrative decisions from California: *In re the Appeal of Joyce, Inc.*, California Board of Equalization (1966); and *In re the Appeal of Finnigan Corporation*, No. 85-623-LB, California Board of Equalization (1990)(*Finnigan II*, on rehearing).

² Appendix A.

³ Appendix B (Subsection E).

⁴ Appendix C, but only with respect to the application of P.L. 86-272. (Subsection E.)

⁵ See Reg. IV.3.(b). Taxable in Another State: When a Corporation Is "Subject to" a Tax under Article IV.3.(1).



EXECUTIVE SUMMARY – THE *JOYCE/FINNIGAN* DEBATE

THE ISSUE

The question at the center of the *Joyce/Finnigan* debate is:

Are states limited in their ability to tax an apportioned share of the income of a unitary business conducted by multiple legal entities if some portion of that income might be attributed to an entity over which the state lacks taxing jurisdiction?

The primary authorities implicated by this question are the unitary business principle, the substantial nexus standard, and P.L. 86-272 (Appendix D).

Simply put, advocates of the *Joyce* theory argue states cannot tax unitary business income that may be attributed to a legal entity over which the state does not have taxing jurisdiction—whether under substantial nexus theories or P.L. 86-272. Advocates of the *Finnigan* theory disagree.

Adoption of the *Joyce* or *Finnigan* theory will directly affect:

- How a state apportions unitary business income earned by multiple entities and how it assigns a portion of the total tax to those entities.
- How the state applies throw-out or throw-back rules to entities in a unitary group (assuming those rules are conditioned on whether sales sourced to another jurisdiction are subject to tax).

Adoption of the *Joyce* or *Finnigan* theory may also indirectly affect:

- How a state treats tax attributes (e.g. NOLs or state tax credits and carryovers, etc.)—assigning them either to each entity or to the group as a whole.

The positions of the states on the *Joyce/Finnigan* debate have fluctuated.⁶ The U.S. Supreme Court has never weighed in despite opportunities to do so.⁷

⁶ See a summary of current positions in Appendix E.

⁷ See *Deluxe Corp. v. Franchise Tax Bd.*, No. 991237 (Cal. Super. Ct. - San Francisco May 28, 1999)(not citable); *Deluxe Corp. v. California Franchise Tax Board*, U.S., No. 01-603, cert. denied, 1/7/02; *Citicorp North America, Inc. v. Franchise Tax Bd.*, 83 Cal.App.4th 1403, 100 Cal.Rptr.2d 509 (App. 1st Dist. 2000)(cert. denied, No. 00-1537, 6/29/01).



CRITICAL DISTINCTION – *JOYCE* IS NOT A THEORY OF JURISDICTION

Both *Joyce* and *Finnigan* are, essentially, theories about how jurisdictional principles are applied. *Joyce* is thought of as an entity-by-entity approach to determining state corporate income tax jurisdiction—whether the determination is made under the substantial nexus standard or under P.L. 86-272. *Finnigan*, in contrast, is thought of as a group approach, looking to the jurisdiction over the unitary business as a whole.

But neither *Joyce* nor *Finnigan* are, themselves, theories of jurisdiction. In particular, *Joyce* does not posit that actions of third parties or affiliates cannot create nexus for a particular entity. Nor does *Joyce* dictate that the activities of an entity's affiliates, which may benefit that entity, must be ignored in reaching an entity-specific determination of jurisdiction. Assume, for example, that the employees of one entity solicit sales in a state for an affiliate. Also assume that, in doing so, those employees take actions that exceed the protections of P.L. 86-272. This would clearly give the state jurisdiction over the affiliate, even under the *Joyce* theory. Likewise, *Finnigan* does not posit that the jurisdictional standards are, themselves, lower. Rather, it posits that the standards can be met, for each entity in the unitary business, if the activities of the unitary business itself meet the standards.

A SIMPLE ILLUSTRATION – COMBINED FILING

Under *Joyce*, a state will not tax a portion of the income of a unitary business that may be attributed to entities over which it lacks jurisdiction. That does not mean, however, that the state effectively uses separate entity filing. Instead, the state starts with the total income for the unitary business, including income attributed to entities over which it lacks jurisdiction. But only entities over which it has jurisdiction are required to apportion their share of that income (whether that is done on a separate or combined report). The denominator of the apportionment factor used by each reporting entity includes the everywhere amounts for the entire unitary business, again, including factor amounts attributed to entities over which the state lacks jurisdiction. The apportionment factor numerator for each reporting entity includes the state-sourced amounts for that reporting entity. In this way, the factors used to apportion income will exclude state-sourced amounts (typically receipts) attributed to entities over which the state lacks jurisdiction.

The following illustration demonstrates that the tax result will differ under separate filing, *Joyce*, and *Finnigan* apportionment methods.



Assume:

- State A uses a single sales factor and imposes a 10% tax.
- Corporations X, Y, and Z are unitary but Z is protected by P.L. 86-272.
- Separate apportionable income and factors for X, Y, and Z in State A (prior to consolidating eliminations) are:

X	\$2 million	\$1 million/\$2 million
Y	\$2 million	\$1 million/\$2 million
Z	\$6 million	\$3 million/\$6 million

- Consolidating eliminations: Z has \$2 million of intercompany sales to X and Y, all of which are sourced to state Z. Z's post-elimination receipts factor, therefore, would be:

Z	\$1 million/\$4 million ⁸
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- Total combined apportionable income is \$10 million.

Separate Basis Tax:

For X and Y *each* = \$2 million X (\$1 million/\$2 million) X 10% = \$100,000

For Z = \$0 (since State A lacks jurisdiction to tax Z under P.L. 86-272)

Total = \$200,000

Joyce Basis Tax:

For X and Y *each* = \$10 million X (\$1 million/\$8 million) X 10% = \$125,000

For Z = \$0 (since State A would exclude its receipts from the factor numerator)

Total = \$250,000

Finnigan Basis Tax:

For group = \$10 million X (\$3 million/\$8 million) X 10% = \$375,000.

Note: If there were no intercompany receipts, the results under the three methods would still be different. And, if State A had a traditional three-factor formula, the difference between *Joyce* and *Finnigan* would be mitigated because the effect of the difference in the receipts factor would be reduced through the averaging of that factor with the property and payroll factors (which, for a protected entity, would likely be zeros). Also, as discussed further below, if State A had a throw-out/back rule, this might affect the tax outcome in some cases, potentially making the tax owed under *Joyce* greater in those cases.

⁸ This report assumes that these intercompany receipts would be eliminated although the Model Statute for Combine Reporting does not explicitly address this point.



THE EFFECT OF THROW-BACK AND THROW-OUT RULES

States that use throw-back or throw-out rules in computing the receipts factor typically condition the application of the rules on whether the seller is subject to tax in the destination state. This condition is met when the destination state lacks taxing jurisdiction over the seller. A state's decision to follow *Joyce* or *Finnigan* for determining the apportionment approach will affect its application of throw-back or throw-out rules. So states that follow *Joyce* throw back (or out) any receipts if the seller, as an entity, is not subject to tax in the destination state. States that follow *Finnigan* will only throw back (or out) any receipts if the group, as a whole, is not subject to tax in the destination state. The overall revenue impact of *Joyce* versus *Finnigan*, therefore, is mitigated by throw-back or throw-out rules.

INTERACTION WITH CONSTITUTIONAL NEXUS AND P.L. 86-272

As noted above, while *Joyce* is not a theory of jurisdiction, its method of applying jurisdictional principles (entity by entity) means that the precise jurisdictional principles, or standards, that are applied may matter more. And, as those standards change, the results under *Joyce* (unlike those under *Finnigan*) are likely to change.

Substantial nexus has certainly evolved beyond traditional jurisdictional principles. For one thing, physical presence is no longer considered necessary for substantial nexus, outside the sales tax area. Some states have explicitly adopted economic presence or similar factor presence standards (applying market sourcing for the receipts portion of that standard). Also, under representative nexus theories, an argument can be made that the activities of an entity's unitary affiliates create nexus for that entity, provided those activities substantially contribute to that entity's portion of the unitary business in the state. These and similar developments make it far more likely that, if a state has substantial nexus with the unitary business, it will also have substantial nexus with most or all of the constituent entities, even on an entity-by-entity basis.

Similarly, the text of P.L. 86-272 clearly recognizes that activities that create jurisdiction include those performed either "by" or "on behalf of" a "taxpayer." And while there have been various arguments suggesting that P.L. 86-272 implicitly intends that only solicitation activities performed on behalf of a business can create nexus, there is no sound authority for these arguments. So, as with substantial nexus, even a *Joyce* state may conclude that activities performed by affiliates in the state, if unprotected, may cause any entity that benefits from those activities to be outside of the federal statute's preemptive scope.



NOL DEDUCTIONS AND STATE TAX CREDITS

States also consider the treatment of NOL deductions, state tax credits, and sometimes other attributes when deciding whether to take a *Joyce* or *Finnigan* approach to combined filing. There is a theoretical connection between how the state treats these items and whether it follows the *Joyce* or *Finnigan* approach. It would appear to be more consistent with the *Joyce* approach to limit NOL deductions and tax credits to the legal entity which gave rise to those items. There may be, however, other reasons to limit the use of NOL deductions or state tax credits to the entity that generated those items. Likewise, a state would not necessarily be prohibited from allowing NOL or credit offsets among a group, even if it were to adopt the *Joyce* approach to apportionment.

OBSERVED PLANNING WITH *JOYCE*

Experience shows that taxpayers may try to use *Joyce* to avoid having sales included in a state's sales factor for the unitary group by isolating activities into separate entities for that purpose. In addition, *Joyce* complicates both combined filing and the determination of substantial nexus, especially where special purpose entities are involved.

POSSIBLE ALTERNATIVE *FINNIGAN* APPROACHES

There are three possible approaches to implementing a *Finnigan* apportionment method:

- Combined returns—The first is to simply impose a tax, filing, and payment obligation on the group, jointly and severally, and to use a combined return that consolidates income and factors (and also handles allocable income).
- Post-apportionment attribution of tax —The second is to take the same apportionment approach as under a combined return but then to attribute a specific portion of the tax to each entity over which the state has jurisdiction.
- Pre-apportionment attribution of state-sourced receipts—The third is to retain the entity-by-entity reporting approach but require the reporting of state-sourced receipts for any entities over which the state lacks jurisdiction, allocating those amounts for inclusion in the factors of the reporting entities.



SUMMARY OF CONSIDERATIONS FOR THE UNIFORMITY COMMITTEE

- The trend is now clearly away from *Joyce* and toward *Finnigan*, although the states are still very much split. (See Appendix E.)⁹
- Adoption of a *Finnigan* “option” may be a simple solution (although keeping the entity-by-entity reporting approach will complicate matters) but having it as an option to *Joyce* does little to advance the cause of uniformity and consistency.
- State uniformity in this area would eliminate the results of the inconsistent treatment of the same receipts. Assuming states have throw-back rules, the same receipts could be included in the receipts factor for two states. In other cases, receipts may end up being excluded from the factor in any state.
- *Finnigan* may be implemented in a simplified fashion, reducing the complexity of combined reporting.
- States will also need to consider what *Finnigan* means in the international context especially when market-sourcing of receipts is adopted.
- While it seems unlikely at this point, the *Finnigan* approach could potentially still be subject to challenge. Also, any challenge of *Finnigan* is more likely to come under P.L. 86-272 and the states might have the opportunity to raise other issues in the context of that challenge.
- Examination of this issue might cause a number of other issues with respect to the model to be raised—so thought will need to be given to whether the scope of the project should, or should not, be limited.

ADDITIONAL RESOURCES

The following are also provided in appendices to this report:

- Appendix F – Past MTC Staff and Uniformity Committee Memos
- Appendix G – *Matter of Disney Enterprises, Inc. v. Tax Appeals Tribunal*

⁹ But even states that adopt the latter approach may determine that they need to attribute a share of the tax owed under that approach to each nexus-entity in the group. This can complicate the reporting of tax, but can be done in a way that does not change the tax amount owed under the general *Finnigan* theory.



APPENDIX A

Multistate Tax Commission Proposed Model Statute for Combined Reporting

*As approved by the Multistate Tax Commission August 17, 2006
As amended by the Multistate Tax Commission July 29, 2011*

Section 1. Definitions.

- A.** “Person” means any individual, firm, partnership, general partner of a partnership, limited liability company, registered limited liability partnership, foreign limited liability partnership, association, corporation (whether or not the corporation is, or would be if doing business in this state, subject to [state income tax act]), company, syndicate, estate, trust, business trust, trustee, trustee in bankruptcy, receiver, executor, administrator, assignee or organization of any kind.
- B.** “Taxpayer” means any person subject to the tax imposed by [State Corporate income tax act].
- C.** “Corporation” means any corporation as defined by the laws of this state or organization of any kind treated as a corporation for tax purposes under the laws of this state, wherever located, which if it were doing business in this state would be a “taxpayer.” The business conducted by a partnership which is directly or indirectly held by a corporation shall be considered the business of the corporation to the extent of the corporation’s distributive share of the partnership income, inclusive of guaranteed payments to the extent prescribed by regulation.
- D.** “Partnership” means a general or limited partnership, or organization of any kind treated as a partnership for tax purposes under the laws of this state.
- E.** “Internal Revenue Code” means Title 26 of the United States Code of [date] [and amendments thereto] without regard to application of federal treaties unless expressly made applicable to states of the United States.
- F.** “Unitary business” means [a single economic enterprise that is made up either of separate parts of a single business entity or of a commonly controlled group of business entities that are sufficiently interdependent, integrated and interrelated through their activities so as to provide a synergy and mutual benefit that produces a sharing or exchange of value among them and a significant flow of value to the separate parts.] Drafter’s note: This portion of the definition is drafted to follow MTC Reg. IV(b), defining a “unitary business.” A state that does not wish to define unitary business in this manner should consider alternative language. In addition, this MTC Regulation defining unitary business includes a requirement of common ownership or control. A state which treats ownership or control requirements separately from the unitary business requirement will need to make additional amendments to the statutory language. Any business conducted by a partnership shall be treated as conducted by its partners, whether directly held or indirectly held through a series of partnerships, to the extent of the partner’s distributive share of the partnership’s income, regardless of the percentage of the partner’s ownership interest or its distributive or any other share of partnership income. A business conducted directly or indirectly by one corporation is unitary with that portion of a business conducted by another



corporation through its direct or indirect interest in a partnership if the conditions of the first sentence of this section 1.F. are satisfied, to wit: there is a synergy, and exchange and flow of value between the two parts of the business and the two corporations are members of the same commonly controlled group.

G. “Combined group” means the group of all persons whose income and apportionment factors are required to be taken into account pursuant to Section 2.A. or 2.B. in determining the taxpayer’s share of the net business income or loss apportionable to this State.

H. “United States” means the 50 states of the United States, the District of Columbia, and United States’ territories and possessions.

I. “Tax haven” means a jurisdiction that, during the tax year in question has no or nominal effective tax on the relevant income and:

(i) has laws or practices that prevent effective exchange of information for tax purposes with other governments on taxpayers benefiting from the tax regime;

(ii) has tax regime which lacks transparency. A tax regime lacks transparency if the details of legislative, legal or administrative provisions are not open and apparent or are not consistently applied among similarly situated taxpayers, or if the information needed by tax authorities to determine a taxpayer’s correct tax liability, such as accounting records and underlying documentation, is not adequately available;

(iii) facilitates the establishment of foreign-owned entities without the need for a local substantive presence or prohibits these entities from having any commercial impact on the local economy;

(iv) explicitly or implicitly excludes the jurisdiction’s resident taxpayers from taking advantage of the tax regime’s benefits or prohibits enterprises that benefit from the regime from operating in the jurisdiction’s domestic market; or

(v) has created a tax regime which is favorable for tax avoidance, based upon an overall assessment of relevant factors, including whether the jurisdiction has a significant untaxed offshore financial/other services sector relative to its overall economy.

Section 2. Combined reporting required, when; discretionary under certain circumstances.

A. Combined reporting required, when. A taxpayer engaged in a unitary business with one or more other corporations shall file a combined report which includes the income, determined under Section 3.C. of this act, and apportionment factors, determined under [provisions on apportionment factors and Section 3.B. of this act], of all corporations that are members of the unitary business, and such other information as required by the Director.

B. Combined reporting at Director’s discretion, when. The Director may, by regulation, require the combined report include the income and associated apportionment factors of any persons that are not included pursuant to Section 2.A., but that are members of a unitary business, in order to reflect proper apportionment of income of entire unitary businesses. Authority to require combination by regulation under this Section 2.B. includes authority to require combination of persons that are not, or would not be if doing business in this state, subject to the [State income tax Act].



In addition, if the Director determines that the reported income or loss of a taxpayer engaged in a unitary business with any person not included pursuant to Section 2.A. represents an avoidance or evasion of tax by such taxpayer, the Director may, on a case by case basis, require all or any part of the income and associated apportionment factors of such person be included in the taxpayer's combined report.

With respect to inclusion of associated apportionment factors pursuant to Section 2.B., the Director may require the exclusion of any one or more of the factors, the inclusion of one or more additional factors which will fairly represent the taxpayer's business activity in this State, or the employment of any other method to effectuate a proper reflection of the total amount of income subject to apportionment and an equitable allocation and apportionment of the taxpayer's income.

Section 3. Determination of taxable income or loss using combined report.

The use of a combined report does not disregard the separate identities of the taxpayer members of the combined group. Each taxpayer member is responsible for tax based on its taxable income or loss apportioned or allocated to this state, which shall include, in addition to other types of income, the taxpayer member's apportioned share of business income of the combined group, where business income of the combined group is calculated as a summation of the individual net business incomes of all members of the combined group. A member's net business income is determined by removing all but business income, expense and loss from that member's total income, as provided in detail below.

A. Components of income subject to tax in this state; application of tax credits and post apportionment deductions.

- i.** Each taxpayer member is responsible for tax based on its taxable income or loss apportioned or allocated to this state, which shall include:
 - (a)** its share of any business income apportionable to this State of each of the combined groups of which it is a member, determined under Section 3.B.,
 - (b)** its share of any business income apportionable to this State of a distinct business activity conducted within and without the state wholly by the taxpayer member, determined under [provisions for apportionment of business income],
 - (c)** its income from a business conducted wholly by the taxpayer member entirely within the state,
 - (d)** its income sourced to this state from the sale or exchange of capital or assets, and from involuntary conversions, as determined under Section 3.C.ii.(g), below,
 - (e)** its nonbusiness income or loss allocable to this State, determined under [provisions for allocation of non-business income],
 - (f)** its income or loss allocated or apportioned in an earlier year, required to be taken into account as state source income during the income year, other than a net operating loss, and
 - (g)** its net operating loss carryover or carryback.

If the taxable income computed pursuant to Section 3 results in a loss for a taxpayer member of the combined group, that taxpayer member has a [state] net operating loss (NOL), subject to the net operating loss limitations, carryforward and carryback provisions of [provisions on NOLs]. Such NOL is applied as a deduction in a prior or subsequent year only if that taxpayer has [State]



source positive net income, whether or not the taxpayer is or was a member of a combined reporting group in the prior or subsequent year.

ii. Except where otherwise provided, no tax credit or post-apportionment deduction earned by one member of the group, but not fully used by or allowed to that member, may be used in whole or in part by another member of the group or applied in whole or in part against the total income of the combined group; and a post-apportionment deduction carried over into a subsequent year as to the member that incurred it, and available as a deduction to that member in a subsequent year, will be considered in the computation of the income of that member in the subsequent year, regardless of the composition of that income as apportioned, allocated or wholly within this state.

B. Determination of taxpayer's share of the business income of a combined group apportionable to this State.

The taxpayer's share of the business income apportionable to this State of each combined group of which it is a member shall be the product of:

- i. the business income of the combined group, determined under Section 3.C., and
- ii. the taxpayer member's apportionment percentage, determined under [provisions on apportionment factors], including in the [property, payroll and sales factor] numerators the taxpayer's [property, payroll and sales, respectively,] associated with the combined group's unitary business in this state, and including in the denominator the [property, payroll and sales] of all members of the combined group, including the taxpayer, which property, payroll and sales are associated with the combined group's unitary business wherever located. The [property, payroll, and sales] of a partnership shall be included in the determination of the partner's apportionment percentage in proportion to a ratio the numerator of which is the amount of the partner's distributive share of partnership's unitary income included in the income of the combined group in accordance with Section 3.C.ii.(c). and the denominator of which is the amount of the partnership's total unitary income.

C. Determination of the business income of the combined group.

The business income of a combined group is determined as follows:

i. From the total income of the combined group, determined under Section 3.C.ii., subtract any income, and add any expense or loss, other than the business income, expense or loss of the combined group.

ii. Except as otherwise provided, the total income of the combined group is the sum of the income of each member of the combined group determined under federal income tax laws, as adjusted for state purposes, as if the member were not consolidated for federal purposes. The income of each member of the combined group shall be determined as follows:

(a) For any member incorporated in the United States, or included in a consolidated federal corporate income tax return, the income to be included in the total income of the combined group shall be the taxable income for the corporation after making appropriate adjustments under [state tax code provisions for adjustments to taxable income].

(b) (1) For any member not included in Section 3.C.ii.(a), the income to be included in the total income of the combined group shall be determined as follows:



(A) A profit and loss statement shall be prepared for each foreign branch or corporation in the currency in which the books of account of the branch or corporation are regularly maintained.

(B) Adjustments shall be made to the profit and loss statement to conform it to the accounting principles generally accepted in the United States for the preparation of such statements except as modified by this regulation.

(C) Adjustments shall be made to the profit and loss statement to conform it to the tax accounting standards required by the [state tax code]

(D) Except as otherwise provided by regulation, the profit and loss statement of each member of the combined group, and the apportionment factors related thereto, whether United States or foreign, shall be translated into the currency in which the parent company maintains its books and records.

(E) Income apportioned to this state shall be expressed in United States dollars.

(2) In lieu of the procedures set forth in Section 3.C.ii.(b)(1), above, and subject to the determination of the Director that it reasonably approximates income as determined under [the State tax code], any member not included in Section 3.C.ii.(a) may determine its income on the basis of the consolidated profit and loss statement which includes the member and which is prepared for filing with the Securities and Exchange Commission by related corporations. If the member is not required to file with the Securities and Exchange Commission, the Director may allow the use of the consolidated profit and loss statement prepared for reporting to shareholders and subject to review by an independent auditor. If above statements do not reasonably approximate income as determined under [the State tax code] the Director may accept those statements with appropriate adjustments to approximate that income.

(c) If a unitary business includes income from a partnership, the income to be included in the total income of the combined group shall be the member of the combined group's direct and indirect distributive share of the partnership's unitary business income.

(d) All dividends paid by one to another of the members of the combined group shall, to the extent those dividends are paid out of the earnings and profits of the unitary business included in the combined report, in the current or an earlier year, be eliminated from the income of the recipient. This provision shall not apply to dividends received from members of the unitary business which are not a part of the combined group.

(e) Except as otherwise provided by regulation, business income from an intercompany transaction between members of the same combined group shall be deferred in a manner similar to 26 CFR 1.1502-13. Upon the occurrence of any of the following events, deferred business income resulting from an intercompany transaction between members of a combined group shall be restored to the income of the seller, and shall be apportioned as business income earned immediately before the event:

(1) the object of a deferred intercompany transaction is

(A) re-sold by the buyer to an entity that is not a member of the combined group,



(B) re-sold by the buyer to an entity that is a member of the combined group for use outside the unitary business in which the buyer and seller are engaged, or

(C) converted by the buyer to a use outside the unitary business in which the buyer and seller are engaged, or

(2) the buyer and seller are no longer members of the same combined group, regardless of whether the members remain unitary.

(f) A charitable expense incurred by a member of a combined group shall, to the extent allowable as a deduction pursuant to Internal Revenue Code Section 170, be subtracted first from the business income of the combined group (subject to the income limitations of that section applied to the entire business income of the group), and any remaining amount shall then be treated as a nonbusiness expense allocable to the member that incurred the expense (subject to the income limitations of that section applied to the nonbusiness income of that specific member). Any charitable deduction disallowed under the foregoing rule, but allowed as a carryover deduction in a subsequent year, shall be treated as originally incurred in the subsequent year by the same member, and the rules of this section shall apply in the subsequent year in determining the allowable deduction in that year.

(g) Gain or loss from the sale or exchange of capital assets, property described by Internal Revenue Code Section 1231(a)(3), and property subject to an involuntary conversion, shall be removed from the total separate net income of each member of a combined group and shall be apportioned and allocated as follows.

(1) For each class of gain or loss (short term capital, long term capital, Internal Revenue Code Section 1231, and involuntary conversions) all members' business gain and loss for the class shall be combined (without netting between such classes), and each class of net business gain or loss separately apportioned to each member using the member's apportionment percentage determined under Section 3.B., above.

(2) Each taxpayer member shall then net its apportioned business gain or loss for all classes, including any such apportioned business gain and loss from other combined groups, against the taxpayer member's nonbusiness gain and loss for all classes allocated to this State, using the rules of Internal Revenue Code Sections 1231 and 1222, without regard to any of the taxpayer member's gains or losses from the sale or exchange of capital assets, Section 1231 property, and involuntary conversions which are nonbusiness items allocated to another state.

(3) Any resulting state source income (or loss, if the loss is not subject to the limitations of Internal Revenue Code Section 1211) of a taxpayer member produced by the application of the preceding subsections shall then be applied to all other state source income or loss of that member.

(4) Any resulting state source loss of a member that is subject to the limitations of Section 1211 shall be carried forward [or carried back] by that member, and shall be treated as state source short-term capital loss incurred by that member for the year for which the carryover [or carryback] applies.



(h) Any expense of one member of the unitary group which is directly or indirectly attributable to the nonbusiness or exempt income of another member of the unitary group shall be allocated to that other member as corresponding nonbusiness or exempt expense, as appropriate.

Section 4. Designation of surety.

As a filing convenience, and without changing the respective liability of the group members, members of a combined reporting group may annually elect to designate one taxpayer member of the combined group to file a single return in the form and manner prescribed by the department, in lieu of filing their own respective returns, provided that the taxpayer designated to file the single return consents to act as surety with respect to the tax liability of all other taxpayers properly included in the combined report, and agrees to act as agent on behalf of those taxpayers for the year of the election for tax matters relating to the combined report for that year. If for any reason the surety is unwilling or unable to perform its responsibilities, tax liability may be assessed against the taxpayer members.

Section 5. Water's-edge election: initiation and withdrawal.

A. Water's-edge election.

Taxpayer members of a unitary group that meet the requirements of Section 5.B. may elect to determine each of their apportioned shares of the net business income or loss of the combined group pursuant to a water's-edge election. Under such election, taxpayer members shall take into account all or a portion of the income and apportionment factors of only the following members otherwise included in the combined group pursuant to Section 2, as described below:

i. the entire income and apportionment factors of any member incorporated in the United States or formed under the laws of any state, the District of Columbia, or any territory or possession of the United States;

ii. the entire income and apportionment factors of any member, regardless of the place incorporated or formed, if the average of its property, payroll, and sales factors within the United States is 20 percent or more;

iii. the entire income and apportionment factors of any member which is a domestic international sales corporations as described in Internal Revenue Code Sections 991 to 994, inclusive; a foreign sales corporation as described in Internal Revenue Code Sections 921 to 927, inclusive; or any member which is an export trade corporation, as described in Internal Revenue Code Sections 970 to 971, inclusive;

iv. any member not described in [Section 5.A.i.] to [Section 5.A.iii.], inclusive, shall include the portion of its income derived from or attributable to sources within the United States, as determined under the Internal Revenue Code without regard to federal treaties, and its apportionment factors related thereto;

v. any member that is a "controlled foreign corporation," as defined in Internal Revenue Code Section 957, to the extent of the income of that member that is defined in Section 952 of Subpart F of the Internal Revenue Code ("Subpart F income") not excluding lower-tier subsidiaries' distributions of such income which were previously taxed, determined without regard to federal treaties, and the apportionment factors related to that income; any item of income received by a controlled foreign corporation shall be excluded if such income was subject to an effective rate of income tax imposed by a foreign country greater than 90 percent of the maximum rate of tax specified in Internal Revenue Code Section 11;



vi. any member that earns more than 20 percent of its income, directly or indirectly, from intangible property or service related activities that are deductible against the business income of other members of the combined group, to the extent of that income and the apportionment factors related thereto; and

vii. the entire income and apportionment factors of any member that is doing business in a tax haven, where “doing business in a tax haven” is defined as being engaged in activity sufficient for that tax haven jurisdiction to impose a tax under United States constitutional standards. If the member’s business activity within a tax haven is entirely outside the scope of the laws, provisions and practices that cause the jurisdiction to meet the criteria established in Section 1.I., the activity of the member shall be treated as not having been conducted in a tax haven.

B. Initiation and withdrawal of election

i. A water’s-edge election is effective only if made on a timely-filed, original return for a tax year by every member of the unitary business subject to tax under [state income tax code]. The Director shall develop rules and regulations governing the impact, if any, on the scope or application of a water’s-edge election, including termination or deemed election, resulting from a change in the composition of the unitary group, the combined group, the taxpayer members, and any other similar change.

ii. Such election shall constitute consent to the reasonable production of documents and taking of depositions in accordance with [state statute on discovery].

iii. In the discretion of the Director, a water’s-edge election may be disregarded in part or in whole, and the income and apportionment factors of any member of the taxpayer's unitary group may be included in the combined report without regard to the provisions of this section, if any member of the unitary group fails to comply with any provision of [this act] or if a person otherwise not included in the water's-edge combined group was availed of with a substantial objective of avoiding state income tax.

iv. A water’s-edge election is binding for and applicable to the tax year it is made and all tax years thereafter for a period of 10 years. It may be withdrawn or reinstated after withdrawal, prior to the expiration of the 10 year period, only upon written request for reasonable cause based on extraordinary hardship due to unforeseen changes in state tax statutes, law, or policy, and only with the written permission of the Director. If the Director grants a withdrawal of election, he or she shall impose reasonable conditions as necessary to prevent the evasion of tax or to clearly reflect income for the election period prior to or after the withdrawal. Upon the expiration of the 10 year period, a taxpayer may withdraw from the water’s edge election. Such withdrawal must be made in writing within one year of the expiration of the election, and is binding for a period of 10 years, subject to the same conditions as applied to the original election. If no withdrawal is properly made, the water’s edge election shall be in place for an additional 10 year period, subject to the same conditions as applied to the original election.



APPENDIX B

Statement of Information Concerning Practices of Multistate Tax Commission and Signatory States Under Public Law 86-272

Originally adopted by the Multistate Tax Commission on July 11, 1986
Revised version adopted by the MTC Executive Committee on January 22, 1993
Second revision adopted by the Multistate Tax Commission on July 29, 1994
Third revision adopted by the Multistate Tax Commission on July 27, 2001

Public Law 86-272, 15 U.S.C. 381-384, (hereafter P.L. 86-272) restricts a state from imposing a net income tax on income derived within its borders from interstate commerce if the only business activity of the company within the state consists of the solicitation of orders for sales of tangible personal property, which orders are to be sent outside the state for acceptance or rejection, and, if accepted, are filled by shipment or delivery from a point outside the state. The term "net income tax" includes a franchise tax measured by net income. If any sales are made into a state which is precluded by P.L. 86-272 from taxing the income of the seller, such sales remain subject to throwback to the appropriate state which does have jurisdiction to impose its net income tax upon the income derived from those sales.

It is the policy of the state signatories hereto to impose their net income tax, subject to State and Federal legislative limitations, to the fullest extent constitutionally permissible. Interpretation of the solicitation of orders standard in P.L. 86-272 requires a determination of the fair meaning of that term in the first instance. The United States Supreme Court has recently established a standard for interpreting the term "solicitation" and this Statement has been revised to conform to such standard. *Wisconsin Department of Revenue v. William Wrigley, Jr., Co.*, 505 U.S. 214, 112 S.Ct. 2447, 120 L.Ed.2d 174 (1992). In those cases where there may be reasonable differences of opinion as to whether the disputed activity exceeds what is protected by P.L. 86-272, the signatory States will apply the principle that the preemption of state taxation that is required by P.L. 86-272 will be limited to those activities that fall within the "clear and manifest purpose of Congress". . See *Department of Revenue of Oregon v. ACF Industries, Inc., et al.*, 510 U.S. 332, 114 S.Ct. 843, 127 L. Ed.2d 165 (1994), *Cipollone v. Liggett Group, Inc.*, 505 U.S. 504, 112 S.Ct. 2608, 120 L. Ed.2d 407, 422 (1992); *Heublein, Inc. v. South Carolina Tax Com.*, 409 U.S. 275, 281-282 (1972).

The following information reflects the signatory states' current practices with regard to: (1) whether a particular factual circumstance is considered under P.L. 86-272 or permitted under this Statement as either protected or not protected from taxation by reason of P.L. 86-272; and (2) the jurisdictional standards which will apply to sales made in another state for purposes of applying a throwback rule (if applicable) with respect to such sales. It is the intent of the signatory states to apply this Statement uniformly to factual circumstances, irrespective of whether such application involves an analysis for jurisdictional purposes in the state into which such tangible personal property has been shipped or delivered or for throwback purposes in the state from which such property has been shipped or delivered.

I NATURE OF PROPERTY BEING SOLD

Only the solicitation to sell personal property is afforded immunity under P.L. 86-272; therefore, the leasing, renting, licensing or other disposition of tangible personal property, or transactions involving intangibles, such as franchises, patents, copyrights, trade marks, service marks and the like, or any other type of property are not protected activities under P.L. 86-272.

The sale or delivery and the solicitation for the sale or delivery of any type of service that is not either (1) ancillary to solicitation or (2) otherwise set forth as a protected activity under the Section IV.B. hereof is also not protected under Public Law 86-272 or this Statement.

II SOLICITATION OF ORDERS AND ACTIVITIES ANCILLARY TO SOLICITATION

For the in-state activity to be a protected activity under P.L. 86-272, it must be limited solely to *solicitation* (except for *de minimis* activities described in Article III. and those activities conducted by independent contractors described in Article V. below). Solicitation means (1) speech or conduct that explicitly or implicitly invites an order; and (2) activities that neither explicitly nor implicitly invite an order, but are entirely ancillary to requests for an order.

Ancillary activities are those activities that serve no independent business function for the seller apart from their connection to the solicitation of orders. Activities that a seller would engage in apart from soliciting orders shall not be considered as ancillary to the solicitation of orders. The mere assignment of activities to sales personnel does not, merely by such assignment, make such activities ancillary to solicitation of orders. Additionally, activities that seek to promote *sales* are not ancillary, because P.L. 86-272 does not protect activity that facilitates sales; it only protects ancillary activities that facilitate the request for an order. The conducting of activities not falling within the foregoing definition of solicitation will cause the company to lose its protection from a net income tax afforded by P.L. 86-272, unless the disqualifying activities, taken together, are either *de minimis* or are otherwise permitted under this Statement.

III DE MINIMIS ACTIVITIES

De minimis activities are those that, when taken together, establish only a trivial connection with the taxing State. An activity conducted within a taxing State on a regular



or systematic basis or pursuant to a company policy (whether such policy is in writing or not) shall normally not be considered trivial. Whether or not an activity consists of a trivial or non-trivial connection with the State is to be measured on both a qualitative and quantitative basis. If such activity either qualitatively or quantitatively creates a non-trivial connection with the taxing State, then such activity exceeds the protection of P.L. 86-272. Establishing that the disqualifying activities only account for a relatively small part of the business conducted within the taxing State is not determinative of whether a *de minimis* level of activity exists. The relative economic importance of the disqualifying in-state activities, as compared to the protected activities, does not determine whether the conduct of the disqualifying activities within the taxing State is inconsistent with the limited protection afforded by P.L. 86-272.

IV

SPECIFIC LISTING OF UNPROTECTED AND PROTECTED ACTIVITIES

The following two listings - IV.A. and IV.B. - set forth the in-state activities that are presently treated by the signatory state as "Unprotected Activities" or "Protected Activities". Such listings may be subject to an amendment by addition or deletion that appears on the individual signatory state's Signature Page attached to this Statement. [*Note: a list of states that have adopted this Statement, together with a compilation of such additions and deletions, is available from the MTC*].

The signatory state has included on the list of "Protected Activities" those in-state activities that are either required protection under P.L. 86-272; or, if not so required, that the signatory state, in its discretion, has permitted protection. The mere inclusion of an activity on the listing of "Protected Activities", therefore, is not a statement or admission by the signatory state that said activity is required any protection under the Public Law.

A. UNPROTECTED ACTIVITIES:

The following in-state activities (assuming they are not of a *de minimis* level) are not considered as either solicitation of orders or ancillary thereto or otherwise protected under P.L. 86-272 and will cause otherwise protected sales to lose their protection under the Public Law:

1. Making repairs or providing maintenance or service to the property sold or to be sold.
2. Collecting current or delinquent accounts, whether directly or by third parties, through assignment or otherwise.
3. Investigating credit worthiness.
4. Installation or supervision of installation at or after shipment or delivery.

5. Conducting training courses, seminars or lectures for personnel other than personnel involved only in solicitation.

6. Providing any kind of technical assistance or service including, but not limited to, engineering assistance or design service, when one of the purposes thereof is other than the facilitation of the solicitation of orders.

7. Investigating, handling, or otherwise assisting in resolving customer complaints, other than mediating direct customer complaints when the sole purpose of such mediation is to ingratiate the sales personnel with the customer.

8. Approving or accepting orders.

9. Repossessing property.

10. Securing deposits on sales.

11. Picking up or replacing damaged or returned property.

12. Hiring, training, or supervising personnel, other than personnel involved only in solicitation.

13. Using agency stock checks or any other instrument or process by which sales are made within this state by sales personnel.

14. Maintaining a sample or display room in excess of two weeks (14 days) at any one location within the state during the tax year.

15. Carrying samples for sale, exchange or distribution in any manner for consideration or other value.

16. Owning, leasing, using or maintaining any of the following facilities or property in-state:

b. Repair shop.

Parts department.

c. Any kind of office other than an in-home office as described as permitted under IV.A.18 and IV.B.2.

e. Warehouse.

f. Meeting place for directors, officers, or employees.

g. Stock of goods other than samples for sales personnel or that are used entirely ancillary to solicitation.

Telephone answering service that is publicly attributed to the company or to employees or agent(s) of the company in their representative status.

Mobile stores, *i.e.*, vehicles with drivers who are sales personnel making sales from the vehicles.

h. Real property or fixtures to real property of any kind.

17. Consigning stock of goods or other tangible personal property to any person, including an independent contractor, for sale.

Maintaining, by any employee or other representative, an office or place of business of any kind (other than an in-home office located within the residence of the employee or representative that (i) is not publicly attributed to the company or to the employee or representative of the company in an employee or representative capacity, and (ii) so long as the use of such office is limited to soliciting and receiving orders from customers; for transmitting such orders outside the state for acceptance or rejection by the company; or for such other activities that are protected under Public Law 86-272 or under paragraph IV.B. of this Statement).

- 18.

A telephone listing or other public listing within the state for the company or for an employee or representative of the company in such capacity or other indications through advertising or business literature that the company or its employee or representative can be contacted at a specific address within the state shall normally be determined as the company maintaining within this state an office or place of business attributable to the company or to its employee or representative in a representative capacity. However, the normal distribution and use of business cards and stationery identifying the employee's or representative's name, address, telephone and fax numbers and affiliation with the company shall not, by itself, be considered as advertising or otherwise publicly attributing an office to the company or its employee or representative.

The maintenance of any office or other place of business in this state that does not strictly qualify as an "in-home" office as described above shall, by itself, cause the loss of protection under this Statement.

For the purpose of this subsection it is not relevant whether the company pays directly, indirectly, or not at all for the cost of maintaining such in-home office.

19. Entering into franchising or licensing agreements; selling or otherwise disposing of franchises and licenses; or selling or otherwise transferring tangible personal property pursuant to such franchise or license by the franchisor or licensor to its franchisee or licensee within the state.
20. [RESERVED.]

21. Conducting any activity not listed in paragraph IV.B. below which is not entirely ancillary to requests for orders, even if such activity helps to increase purchases.

B. PROTECTED ACTIVITIES :

The following in-state activities will not cause the loss of protection for otherwise protected sales:

1. Soliciting orders for sales by any type of advertising.
2. Soliciting of orders by an in-state resident employee or representative of the company, so long as such person does not maintain or use any office or other place of business in the state other than an "in-home" office as described in IV.A.18. above.
3. Carrying samples and promotional materials only for display or distribution without charge or other consideration.
4. Furnishing and setting up display racks and advising customers on the display of the company's products without charge or other consideration.
5. Providing automobiles to sales personnel for their use in conducting protected activities.
6. Passing orders, inquiries and complaints on to the home office.
7. Missionary sales activities; i.e., the solicitation of indirect customers for the company's goods. For example, a manufacturer's solicitation of retailers to buy the manufacturer's goods from the manufacturer's wholesale customers would be protected if such solicitation activities are otherwise immune.
8. Coordinating shipment or delivery without payment or other consideration and providing information relating thereto either prior or subsequent to the placement of an order.
9. Checking of customers' inventories without a charge therefor (for re-order, but not for other purposes such as quality control).
10. Maintaining a sample or display room for two weeks (14 days) or less at any one location within the state during the tax year.
11. Recruiting, training or evaluating sales personnel, including occasionally using homes, hotels or similar places for meetings with sales personnel.

12. Mediating direct customer complaints when the purpose thereof is solely for ingratiating the sales personnel with the customer and facilitating requests for orders.
13. Owning, leasing, using or maintaining personal property for use in the employee or representative's "in-home" office or automobile that is solely limited to the conducting of protected activities. Therefore, the use of personal property such as a cellular telephone, facsimile machine, duplicating equipment, personal computer and computer software that is limited to the carrying on of protected solicitation and activity entirely ancillary to such solicitation or permitted by this Statement under paragraph IV.B. shall not, by itself, remove the protection under this Statement.

V

INDEPENDENT CONTRACTORS

P.L. 86-272 provides protection to certain in-state activities if conducted by an independent contractor that would not be afforded if performed by the company or its employees or other representatives. Independent contractors may engage in the following limited activities in the state without the company's loss of immunity:

1. Soliciting sales.
2. Making sales.
3. Maintaining an office.

Sales representatives who represent a single principal are not considered to be independent contractors and are subject to the same limitations as those provided under P.L. 86-272 and this Statement.

Maintenance of a stock of goods in the state by the independent contractor under consignment or any other type of arrangement with the company, except for purposes of display and solicitation, shall remove the protection.

VI

APPLICATION OF DESTINATION STATE LAW IN CASE OF CONFLICT

When it appears that two or more signatory states have included or will include the same receipts from a sale in their respective sales factor numerators, at the written request of the company, said states will in good faith confer with one another to determine which state should be assigned said receipts. Such conference shall identify

what law, regulation or written guideline, if any, has been adopted in the state of destination with respect to the issue. The state of destination shall be that location at which the purchaser or its designee actually receives the property, regardless of f.o.b. point or other conditions of sale.

In determining which state is to receive the assignment of the receipts at issue, preference shall be given to any clearly applicable law, regulation or written guideline that has been adopted in state of destination. However, except in the case of the definition of what constitutes "tangible personal property", this state is not required by this Statement to follow any other state's law, regulation or written guideline should this state determine that to do so (i) would conflict with its own laws, regulations, or written guidelines and (ii) would not clearly reflect the income-producing activity of the company within this state.

Notwithstanding any provision set forth in this Statement to the contrary, as between this state and any other signatory state, this state agrees to apply the definition of "tangible personal property" that exists in the state of destination to determine the application of P.L. 86-272 and issues of throwback, if any. Should the state of destination not have any applicable definition of such term so that it could be reasonably determined whether the property at issue constitutes "tangible personal property", then each signatory state may treat such property in any manner that would clearly reflect the income-producing activity of the company within said state.

VII MISCELLANEOUS PRACTICES

A. APPLICATION OF STATEMENT TO FOREIGN COMMERCE.

Public Law 86-272 specifically applies, by its terms, to "interstate commerce" and does not directly apply to foreign commerce. The states are free, however, to apply the same standards set forth in the Public Law and in this Statement to business activities in foreign commerce to ensure that foreign and interstate commerce are treated on the same basis. Such an application also avoids the necessity of expensive and difficult efforts in the identification and application of the varied jurisdictional laws and rules existing in foreign countries.

This state will apply the provisions of Public Law 86-272 and of this Statement to business activities conducted in foreign commerce. Therefore, whether business activities are conducted by (i) a foreign or domestic company selling tangible personal property into a country outside of the United States from a point within this state or by (ii) either company selling such property into this state from a point outside of the United States, the principles under this Statement apply equally to determine whether the sales transactions are protected and the company immune from taxation in either this state or in the foreign country, as the case might be, and whether, if applicable, this state will apply its throwback provisions.

B. APPLICATION TO CORPORATION INCORPORATED IN STATE OR TO PERSON RESIDENT OR DOMICILED IN STATE

The protection afforded by P.L. 86-272 and the provisions of this Statement do not apply to any corporation incorporated within this state or to any person who is a resident of or domiciled in this state.

C. REGISTRATION OR QUALIFICATION TO DO BUSINESS.

A company that registers or otherwise formally qualifies to do business within this state does not, by that fact alone, lose its protection under P.L. 86-272. Where, separate from or ancillary to such registration or qualification, the company receives and seeks to use or protect any additional benefit or protection from this state through activity not otherwise protected under P.L. 86-272 or this Statement, such protection shall be removed.

D. LOSS OF PROTECTION FOR CONDUCTING UNPROTECTED ACTIVITY DURING PART OF TAX YEAR.

The protection afforded under P.L. 86-272 and the provisions of this Statement shall be determined on a tax year by tax year basis. Therefore, if at any time during a tax year the company conducts activities that are not protected under P.L. 86-272 or this Statement, no sales in this state or income earned by the company attributed to this state during any part of said tax year shall be protected from taxation under said Public Law or this Statement.

E. APPLICATION OF THE *JOYCE RULE*.

In determining whether the activities of any company have been conducted within this state beyond the protection of P.L. 86-272 or paragraph IV.B. of this Statement, the principle established in *Appeal of Joyce, Inc.*, Cal. St. Bd. of Equal. (11/23/66), commonly known as the "Joyce Rule", shall apply. Therefore, only those in-state activities that are conducted by or on behalf of said company shall be considered for this purpose. Activities that are conducted by any other person or business entity, whether or not said person or business entity is affiliated with said company, shall not be considered attributable to said company, unless such other person or business entity was acting in a representative capacity on behalf of said company.

APPENDIX C

Factor Presence Nexus Standard for Business Activity Taxes

Approved by the Multistate Tax Commission
October 17, 2002

The Commission adopted the following uniformity proposal as part of an amendment to MTC Policy Statement 02-02, Ensuring the Equity, Integrity and Viability of State Income Tax Systems, approved on October 17, 2002. A working group of states formulated the proposal over several months through public teleconferences and the Commission held four public hearings covering the technical, policy and constitutional aspects of the proposed provision. This factor presence nexus standard is intended to represent a simple, certain and equitable standard for the collection of state business activity taxes. Professor Charles McLure, Senior Fellow with the Hoover Institution at Stanford University, originated the idea of factor presence nexus and set forth an explanation of the concept in his December 2000 National Tax Journal article entitled, "Implementing State Corporate Income Taxes in the Digital Age." Professor McLure reiterated his concept during the Commission's July 2001 Federalism at Risk seminar.

- A. (1) Individuals who are residents or domiciliaries of this State and business entities that are organized or commercially domiciled in this State have substantial nexus with this State.
- (2) Nonresident individuals and business entities organized outside the State that are doing business in this State have substantial nexus and are subject to [list appropriate business activity taxes for the state, with statutory citations] when in any tax period the property, payroll or sales of the individual or business in the State, as they are defined below in Subsection C, exceeds the thresholds set forth in Subsection B.
- B. (1) Substantial nexus is established if any of the following thresholds is exceeded during the tax period:
- (a) a dollar amount of \$50,000 of property; or
 - (b) a dollar amount of \$50,000 of payroll; or
 - (c) a dollar amount of \$500,000 of sales; or
 - (d) twenty-five percent of total property, total payroll or total sales.
- (2) At the end of each year, the [tax administrator] shall review the cumulative percentage change in the consumer price index. The [tax administrator] shall adjust the thresholds set forth in paragraph (1) if the consumer price index has changed by

5% or more since January 1, 2003, or since the date that the thresholds were last adjusted under this subsection. The thresholds shall be adjusted to reflect that cumulative percentage change in the consumer price index. The adjusted thresholds shall be rounded to the nearest \$1,000. As used in this subsection, "consumer price index" means the Consumer Price Index for All Urban Consumers (CPI-U) available from the Bureau of Labor Statistics of the United States Department of Labor. Any adjustment shall apply to tax periods that begin after the adjustment is made.

C. Property, payroll and sales are defined as follows:

(1) Property counting toward the threshold is the average value of the taxpayer's real property and tangible personal property owned or rented and used in this State during the tax period. Property owned by the taxpayer is valued at its original cost basis. Property rented by the taxpayer is valued at eight times the net annual rental rate. Net annual rental rate is the annual rental rate paid by the taxpayer less any annual rental rate received by the taxpayer from sub-rentals. The average value of property shall be determined by averaging the values at the beginning and ending of the tax period; but the tax administrator may require the averaging of monthly values during the tax period if reasonably required to reflect properly the average value of the taxpayer's property.

(2) Payroll counting toward the threshold is the total amount paid by the taxpayer for compensation in this State during the tax period. Compensation means wages, salaries, commissions and any other form of remuneration paid to employees and defined as gross income under Internal Revenue Code § 61. Compensation is paid in this State if (a) the individual's service is performed entirely within the State; (b) the individual's service is performed both within and without the State, but the service performed without the State is incidental to the individual's service within the State; or (c) some of the service is performed in the State and (1) the base of operations or, if there is no base of operations, the place from which the service is directed or controlled is in the State, or (2) the base of operations or the place from which the service is directed or controlled is not in any State in which some part of the service is performed, but the individual's residence is in this State.

(3) Sales counting toward the threshold include the total dollar value of the taxpayer's gross receipts, including receipts from entities that are part of a commonly owned enterprise as defined in D(2) of which the taxpayer is a member, from

(a) the sale, lease or license of real property located in this State;

(b) the lease or license of tangible personal property located in this State;

(c) the sale of tangible personal property received in this State as indicated by receipt at a business location of the seller in this State or by instructions, known to the seller, for delivery or shipment to a purchaser (or to another at the direction of the purchaser) in this State; and

- (d) The sale, lease or license of services, intangibles, and digital products for primary use by a purchaser known to the seller to be in this State. If the seller knows that a service, intangible, or digital product will be used in multiple States because of separate charges levied for, or measured by, the use at different locations, because of other contractual provisions measuring use, or because of other information provided to the seller, the seller shall apportion the receipts according to usage in each State.
- (e) If the seller does not know where a service, intangible, or digital product will be used or where a tangible will be received, the receipts shall count toward the threshold of the State indicated by an address for the purchaser that is available from the business records of the seller maintained in the ordinary course of business when such use does not constitute bad faith. If that is not known, then the receipts shall count toward the threshold of the State indicated by an address for the purchaser that is obtained during the consummation of the sale, including the address of the purchaser's payment instrument, if no other address is available, when the use of this address does not constitute bad faith.

(4) Notwithstanding the other provisions of this Subsection C, for a taxpayer subject to the special apportionment methods under [Multistate Tax Commission Regulations IV.18.(d) through (j)], the property, payroll and sales for measuring against the nexus thresholds shall be defined as they are for apportionment purposes under those regulations. Financial institutions subject to an apportioned income or franchise tax shall determine property, payroll and sales for nexus threshold purposes the same as for apportionment purposes under the [MTC Recommended Formula for the Apportionment and Allocation of Net Income of Financial Institutions]. Pass-through entities, including, but not limited to, partnerships, limited liability companies, S corporations, and trusts, shall determine threshold amounts at the entity level. If property, payroll or sales of an entity in this State exceeds the nexus threshold, members, partners, owners, shareholders or beneficiaries of that pass-through entity are subject to tax on the portion of income earned in this State and passed through to them.

- D. (1) Entities that are part of a commonly owned enterprise shall determine whether they meet the threshold for nexus as follows:
 - (a) Commonly owned enterprises shall first aggregate the property, payroll and sales of their entities that have a minimum presence in this State of \$5000 of combined property, payroll and sales, including those entities that independently exceed a threshold and separately have nexus. The aggregate number shall be reduced based on detailed disclosure of any intercompany transactions where inclusion would result in one State's double counting assets or revenue. If that aggregation of property, payroll and sales meets any threshold in Subsection B,

the enterprise shall file a joint information return as specified by the [tax agency] separately listing the property, payroll and sales in this State of each entity.

(b) Those entities of the commonly owned enterprise that are listed in the joint information return and that are also part of a unitary business grouping conducting business in this State shall then aggregate the property, payroll and sales of each such unitary business grouping on the joint information return. The aggregate number shall be reduced based on detailed disclosure of any intercompany transactions where inclusion would result in one State's double counting assets or revenue. The entities shall base the unitary business groupings on the unitary combined report filed in this State. If no unitary combined report is required in this State, then the taxpayer shall use the unitary business groupings the taxpayer most commonly reports in States that require combined returns.

(c) If the aggregate property, payroll or sales in this State of the entities of any unitary business of the enterprise meets a threshold in Subsection B, then each entity that is part of that unitary business is deemed to have nexus and shall file and pay income or franchise tax as required by law.

(2) "Commonly owned enterprise" means a group of entities under common control either through a common parent that owns, or constructively owns, more than 50 percent of the voting power of the outstanding stock or ownership interests or through five or fewer individuals (individuals, estates or trusts) that own, or constructively own, more than 50 percent of the voting power of the outstanding stock or ownership interests taking into account the ownership interest of each such person only to the extent such ownership is identical with respect to each such entity.

- E. A State without jurisdiction to impose tax on or measured by net income on a particular taxpayer because that taxpayer comes within the protection of Public Law 86-272 (15 U.S.C. § 381) does not gain jurisdiction to impose such a tax even if the taxpayer's property, payroll or sales in the State exceeds a threshold in Subsection B. Public Law 86-272 preempts the state's authority to tax and will therefore cause sales of each protected taxpayer to customers in the State to be thrown back to those sending States that require throwback. If Congress repeals the application of Public Law 86-272 to this State, an out-of-state business shall not have substantial nexus in this State unless its property, payroll or sales exceeds a threshold in this provision.



APPENDIX D – P.L. 86-272

5 U.S. Code § 381 - Imposition of net income tax

(a) Minimum standards. No State, or political subdivision thereof, shall have power to impose, for any taxable year ending after September 14, 1959, a net income tax on the income derived within such State by any person from interstate commerce if the only business activities within such State by or on behalf of such person during such taxable year are either, or both, of the following:

(1) the solicitation of orders by such person, or his representative, in such State for sales of tangible personal property, which orders are sent outside the State for approval or rejection, and, if approved, are filled by shipment or delivery from a point outside the State; and

(2) the solicitation of orders by such person, or his representative, in such State in the name of or for the benefit of a prospective customer of such person, if orders by such customer to such person to enable such customer to fill orders resulting from such solicitation are orders described in paragraph (1).

(b) Domestic corporations; persons domiciled in or residents of a State. The provisions of subsection (a) shall not apply to the imposition of a net income tax by any State, or political subdivision thereof, with respect to—

(1) any corporation which is incorporated under the laws of such State; or

(2) any individual who, under the laws of such State, is domiciled in, or a resident of, such State.

(c) Sales or solicitation of orders for sales by independent contractors.

For purposes of subsection (a), a person shall not be considered to have engaged in business activities within a State during any taxable year merely by reason of sales in such State, or the solicitation of orders for sales in such State, of tangible personal property on behalf of such person by one or more independent contractors, or by reason of the maintenance, of an office in such State by one or more independent contractors whose activities on behalf of such person in such State consist solely of making sales, or soliciting orders for sales, or tangible personal property.



(d)Definitions. For purposes of this section—

(1)the term “independent contractor” means a commission agent, broker, or other independent contractor who is engaged in selling, or soliciting orders for the sale of, tangible personal property for more than one principal and who holds himself out as such in the regular course of his business activities; and

(2)the term “representative” does not include an independent contractor.

(Pub. L. 86-272, title I, § 101, Sept. 14, 1959, 73 Stat. 555.)

APPENDIX E

Topic	Allocation and Apportionment The Sales Factor Throwback and Throwout Rules Joyce and Finnigan Rules for Combined Reporting	Group Taxation Combined Returns Computation of Combined Taxable Income Apportionment and Allocation Joyce vs. Finnigan
Alabama	No combined reporting. Alabama does not permit taxpayers to file combined returns. [Ala. Code § 40-18-39(i); Ala. Admin. Code r. 810-27-1-.09.] BNA-CITN AL 6.4.4.3.	Not permitted. Alabama does not permit taxpayers to file combined returns. Ala. Code § 40-18-39(i). BNA-CITN AL 8.3.3.4.6.
Alaska	Neither. Alaska does not follow either the Joyce or Finnigan rules.] BNA-CITN AK 6.4.4.3.	Joyce. Alaska follows the Joyce rule.[Bloomberg BNA Survey of State Tax Departments.] BNA-CITN AK 8.3.3.4.6.
Arizona	Finnigan rule. Arizona follows the Finnigan rule. Ariz. Admin. Code 15-2D-404.B. BNA-CITN AZ 6.4.4.3.	Finnigan. Arizona follows the Finnigan rule. Ariz. Admin. Code R15-2D-404(B). BNA-CITN AZ 8.3.3.4.6.
Arkansas	No combined reporting. Arkansas does not permit taxpayers to file combined returns. [Ark. Code Ann. § 26-51-804.] BNA-CITN AR 6.4.4.3.	Not permitted. Arkansas does not permit taxpayers to file combined returns. Ark. Regs. 3.26-51-701. BNA-CITN AR 8.3.3.4.6.
California	Finnigan. California follows the Finnigan rule. [Cal. Rev. & Tax. Code § 25135; Cal. Code Regs. tit. 18, § 25106.5(c)(7)(A)(iii).] BNA-CITN CA 6.4.4.3.	Finnigan. California follows the Finnigan rule. [Cal. Rev. & Tax. Code § 25135(b); Cal. Code Regs. tit. 18, § 25106.5(c)(7)(A)(1)(b)(iii).] BNA-CITN CA 8.3.3.4.6.
Colorado	Joyce. Colorado follows the Joyce rule. Colo. Rev. Stat. § 39-22-303(11)(c)(II). BNA-CITN CO 6.4.4.3.	Joyce. Colorado follows the Joyce rule. Colo. Rev. Stat. § 39-22-303(11)(c)(II); 39 Colo. Code Regs. § 22-303.5.4(a)(3).
Connecticut	Finnigan. Connecticut follows the Finnigan rule.[Conn. Gen. Stat. §§ 12-213(a)(29).] BNA-CITN CT 6.4.4.3.	Finnigan. Connecticut follows the Finnigan rule.[Conn. Gen. Stat. §§ 12-213(a)(29), 12-213(a)(35), 12-213(a)(36), and 12-218e(b).]
Delaware	No combined reporting. Delaware does not permit taxpayers to file combined returns. [Delaware Form 1100, Corporation Income Tax Return, Instructions.] BNA-CITN DE 6.4.4.3.	Not permitted. Delaware does not permit taxpayers to file combined returns. Del. Div. of Rev., Instructions to Form 1100, Corporation Income Tax Return. BNA-CITN DE 8.3.3.4.6.
District of Columbia	Joyce. The District of Columbia follows the Joyce rule.[D.C. Mun. Regs. tit. 9, § 169.1.] BNA-CITN DC 6.4.4.3.	Joyce. The District of Columbia follows the Joyce rule.[D.C. Mun. Regs. tit. 9, § 169.1.] BNA-CITN DC 8.3.3.4.6.

Topic	Allocation and Apportionment The Sales Factor Throwback and Throwout Rules Joyce and Finnigan Rules for Combined Reporting	Group Taxation Combined Returns Computation of Combined Taxable Income Apportionment and Allocation Joyce vs. Finnigan
Florida	No combined reporting. Florida does not permit taxpayers to file combined returns. [Fla. Admin. Code Ann. r. 12C-1.015(7).] BNA-CITN FL 6.4.4.3.	Not permitted. Florida does not permit taxpayers to file combined returns. BNA-CITN FL 8.3.3.4.6.
Georgia	No combined reporting. Georgia does not permit taxpayers to file combined returns. [Ga. Code Ann. § 48-7-21(b)(7)(A).] BNA-CITN GA 6.4.4.3.	Not permitted. Georgia does not permit taxpayers to file combined returns. BNA-CITN GA 8.3.3.4.6.
Hawaii	Joyce. Hawaii follows the Joyce rule.[Haw. Regs. § 18-235-22-03; Tax Information Release 95-3 appendix, para. VII.E.] BNA-CITN HI 6.4.4.3.	Joyce. Hawaii follows the Joyce rule. Haw. Regs. § 18-235-22-03. BNA-CITN HI 8.3.3.4.6.
Idaho	Joyce. Idaho follows the Joyce rule.[Idaho Regs. § 35.01.01.365.05.] BNA-CITN ID 6.4.4.3.	Joyce. Idaho follows the Joyce rule.[Idaho Regs. § 35.01.01.365.05.] BNA-CITN ID 8.3.3.4.6.
Illinois	Joyce. Illinois follows the Joyce rule.[Ill. Admin. Code tit. 86, § 100.9720(f).] BNA-CITN IL 6.4.4.3.	Joyce. Illinois follows the Joyce rule.[Ill. Admin. Code tit. 86, §§ 100.9720(f), 100.5270(b)(1).] BNA-CITN IL 8.3.3.4.6.
Indiana	Finnigan. Indiana follows the Finnigan rule. Ind. Dept. of Rev., Indiana Tax Policy Directive 6 (June 1992). BNA-CITN IN 6.4.4.3.	Finnigan. Indiana follows the Finnigan rule. Ind. Dept. of Rev., Tax Policy Directive 6 (June 1992). BNA-CITN IN 8.3.3.4.6.
Iowa	No combined reporting. Iowa does not permit taxpayers to file combined returns. [Iowa Code Ann. § 422.37.] BNA-CITN IA 6.4.4.3.	Not permitted. Iowa does not permit taxpayers to file combined returns. BNA-CITN IA 8.3.3.4.6.
Kansas	Finnigan. Kansas follows the Finnigan rule. [Kan. Admin. Regs. 92-12-112(a).] BNA-CITN KS 6.4.4.3.	Finnigan. Kansas follows the Finnigan rule. Kan. Admin. Regs. 92-12-112(a); Kan. Dept. of Rev., Revenue Ruling 12-91-1 (Jan. 1, 1991).

Topic	Allocation and Apportionment The Sales Factor Throwback and Throwout Rules Joyce and Finnigan Rules for Combined Reporting	Group Taxation Combined Returns Computation of Combined Taxable Income Apportionment and Allocation Joyce vs. Finnigan
Kentucky	No combined reporting. Kentucky does not permit taxpayers to file combined returns. [Ky. Rev. Stat. Ann. § 141.200(15).] BNA-CITN KY 6.4.4.3.	Yes. For taxable years beginning on or after Jan. 1, 2019, Kentucky will require taxpayers engaged in a unitary business to file a combined report. 2018 Ky. H.B. 487, § 120, effective for taxable years beginning on or after Jan. 1, 2019.
Louisiana	No combined reporting. Louisiana does not permit taxpayers to file combined returns. [La. Admin. Code tit. 61, § 1175.] BNA-CITN LA 6.4.4.3.	Not permitted. Louisiana does not permit taxpayers to file combined returns, unless specifically required by the Secretary of Revenue. La. Rev. Stat. Ann. § 47:287.480(3); La. Rev. Stat. Ann. § 47:287.733.
Maine	Finnigan. Maine follows the Finnigan rule.[Maine Tax Alert, Vol. 20, No. 9 (Sept. 2010).] BNA-CITN ME 6.4.4.3.	Finnigan. Maine follows the Finnigan rule.[Maine Tax Alert, Vol. 20, No. 9 (Sept. 2010).] BNA-CITN ME 8.3.3.4.6.
Maryland	No combined reporting. Maryland does not permit taxpayers to file combined returns. [Md. Regs. Code § 03.04.03.03.] BNA-CITN MD 6.4.4.3.	Not permitted. Maryland does not permit taxpayers to file combined returns. [Md. Code Ann. Tax-Gen. § 10-811.] BNA-CITN MD 8.3.3.4.6.
Massachusetts	Finnigan. Massachusetts follows the Finnigan rule. Mass. Dept. of Rev., Massachusetts Technical Information Release TIR 08-11 (Aug. 15, 2008). BNA-CITN MA 6.4.4.3.	Finnigan. Massachusetts follows the Finnigan rule. Massachusetts Technical Information Release TIR 08-11 (Aug. 15, 2008); Mass. Regs. Code tit. 830, § 63.32B.2(7)(b). BNA-CITN MA 8.3.3.4.6.
Michigan	Finnigan Michigan follows the Finnigan rule. [Mich. Comp. Laws § 206.691; Mich. Comp. Laws § 206.663(2); Mich. Comp. Laws § 208.1511.]	Finnigan. Michigan follows the Finnigan rule. [Mich. Comp. Laws § 206.691; Mich. Comp. Laws § 206.663(2); Mich. Comp. Laws § 208.1511.] BNA-CITN MI 8.3.3.4.6.
Minnesota	Finnigan. Minnesota follows the Finnigan rule.[Minn. Stat. § 290.17(4)(f).] BNA-CITN MN 6.4.4.3.	Finnigan. Minnesota follows the Finnigan rule.[Minn. Stat. § 290.17(4)(f).] BNA-CITN MN 8.3.3.4.6.
Mississippi	Joyce. Mississippi follows the Joyce rule. BNA-CITN MS 6.4.4.3.	Joyce. Mississippi follows the Joyce rule. [Miss. Regs. § 35.III.08.07.102.02.]

Topic	Allocation and Apportionment The Sales Factor Throwback and Throwout Rules Joyce and Finnigan Rules for Combined Reporting	Group Taxation Combined Returns Computation of Combined Taxable Income Apportionment and Allocation Joyce vs. Finnigan
Missouri	No combined reporting. Missouri does not permit taxpayers to file combined returns. [Mo. Code Regs. Ann. tit. 12, § 10-2.075(66).] BNA-CITN MO 6.4.4.3.	Not permitted. Missouri does not permit taxpayers to file combined returns. Mo. Code Regs. Ann. tit. 12, § 10-2.075(66). BNA-CITN MO 8.3.3.4.6.
Montana	Finnigan. Montana follows the Finnigan rule.[Mont. Admin. R. 42.26.260.] BNA-CITN MT 6.4.4.3.	Joyce. Montana follows the Joyce rule. Mont. Admin. R. 42.26.511(1). BNA-CITN MT 8.3.3.4.6.
Nebraska	Joyce. Nebraska follows the Joyce rule. [Neb. Admin. R. & Regs. 316-24-053.03(C).] BNA-CITN NE 6.4.4.3.	Joyce. Nebraska follows the Joyce rule. Neb. Admin. R. & Regs. 316-24-053.03(C). BNA-CITN NE 8.3.3.4.6.
Nevada	No corporate income tax. Nevada does not impose a corporate income tax. BNA-CITN NV 6.4.4.3.	No corporate income tax. Nevada does not impose a corporate income tax. BNA-CITN NV 8.3.3.4.6.
New Hampshire	Joyce. New Hampshire follows the Joyce rule. [N.H. Code Admin. R. Dept. Rev. Admin. 304.01(h); N.H. Code Admin. R. Dept. Rev. Admin. 304.01(h); N.H. Rev. Stat. Ann. § 77-A:3(III).] BNA-CITN NH 6.4.4.3.	Joyce. New Hampshire follows the Joyce rule. [N.H. Code Admin. R. Dept. Rev. Admin. 304.01(g).] BNA-CITN NH 8.3.3.4.6.
New Jersey	No combined reporting. New Jersey does not permit taxpayers to file combined returns. [N.J. Admin. Code tit. 18, § 7-5.1.] BNA-CITN NJ 6.4.4.3.	Not permitted. New Jersey does not permit taxpayers to file combined returns. BNA-CITN NJ 8.3.3.4.6.
New Mexico	Joyce. New Mexico follows the Joyce rule. [N.M. Stat. Ann. § 7-4-17(A).] BNA-CITN NM 6.4.4.3.	Joyce. New Mexico follows the Joyce rule. [N.M. Stat. Ann. § 7-4-17(A).] BNA-CITN NM 8.3.3.4.6.
New York	Finnigan. New York follows the Finnigan rule. Matter of Disney Enterprises, Inc. v. New York Tax App. Trib., 10 N.Y.3d 392, 888 N.E.2d 1029 (N.Y. 2008). BNA-CITN NY 6.4.4.3.	Finnigan. New York follows the Finnigan rule. [N.Y. Tax Law § 210-C(5)(a); N.Y. Comp. Codes R. & Regs. tit. 20, § 4-4.8.] BNA-CITN NY 8.3.3.4.6.

Topic	Allocation and Apportionment The Sales Factor Throwback and Throwout Rules Joyce and Finnigan Rules for Combined Reporting	Group Taxation Combined Returns Computation of Combined Taxable Income Apportionment and Allocation Joyce vs. Finnigan
North Carolina	Finnigan. North Carolina follows the Finnigan rule. N.C. Gen. Stat. § 105-130.14. BNA-CITN NC 6.4.4.3.	Finnigan. North Carolina follows the Finnigan rule. N.C. Admin. Code tit. 17, r. 05F.0501(5). BNA-CITN NC 8.3.3.4.6.
North Dakota	Joyce. North Dakota follows the Joyce rule. [N.D. Admin. Code § 81-03-09-28.] BNA-CITN ND 6.4.4.3.	Joyce. North Dakota follows the Joyce rule. [N.D. Admin. Code § 81-03-09-28.] BNA-CITN ND 8.3.3.4.6.
Ohio	No. Ohio does not use an apportionment formula for Commercial Activity Tax purposes. Ohio Rev. Code Ann. § 5751.01. BNA-CITN OH 6.4.4.3.	Neither. Ohio does not follow the Joyce or Finnigan rules. BNA-CITN OH 8.3.3.4.6.
Oklahoma	No combined reporting. Oklahoma does not permit taxpayers to file combined returns. [Okla. Admin. Code § 710:50-17-34.] BNA-CITN OK 6.4.4.3.	Not permitted. Oklahoma does not permit taxpayers to file combined returns. [Okla. Admin. Code § 710:50-17-31(b).] BNA-CITN OK 8.3.3.4.6.
Oregon	No combined reporting. Oregon does not permit taxpayers to file combined returns. [Or. Rev. Stat. § 317.710.]	Not permitted. Oregon does not permit taxpayers to file combined returns. BNA-CITN OR 8.3.3.4.6.
Pennsylvania	No combined reporting. Pennsylvania does not permit taxpayers to file combined returns. [72 Pa. Stat. § 7404.]	Not permitted. Pennsylvania does not permit taxpayers to file combined returns. 72 Pa. Stat. § 7404. BNA-CITN PA 8.3.3.4.6.
Rhode Island	Finnigan. Rhode Island follows the Finnigan rule. R.I. Gen. Laws § 44-11-4.1(a); R.I. Regs. § CT 15-02, Rule 8(b); R.I. Regs. § CT 15-04, Rule 8(e). For tax years beginning before Jan. 1, 2015 Rhode Island did not permit combined reporting. BNA-CITN RI 6.4.4.3.	Finnigan. Rhode Island follows the Finnigan rule. [R.I. Gen. Laws § 44-11-4.1(a); R.I. Regs. § CT 16-17, Rule 10(f).] BNA-CITN RI 8.3.3.4.6.
South Carolina	Finnigan. South Carolina follows the Finnigan rule.[South Carolina Revenue Ruling No. 15-5 (June 12, 2015).] BNA-CITN SC 6.4.4.3.	Finnigan. South Carolina follows the Finnigan rule.[South Carolina Revenue Ruling No. 15-5 (June 12, 2015).] BNA-CITN SC 8.3.3.4.6.

Topic	Allocation and Apportionment The Sales Factor Throwback and Throwout Rules Joyce and Finnigan Rules for Combined Reporting	Group Taxation Combined Returns Computation of Combined Taxable Income Apportionment and Allocation Joyce vs. Finnigan
South Dakota	No corporate income tax. South Dakota does not impose a corporate income tax. BNA-CITN SD 6.4.4.3.	No corporate income tax. South Dakota does not impose a corporate income tax. BNA-CITN SD 8.3.3.4.6.
Tennessee	No combined reporting. Tennessee does not permit taxpayers to file combined returns. [Tenn. Code Ann. § 67-4-2007(e).] BNA-CITN TN 6.4.4.3.	Neither. Tennessee does not follow the Joyce or Finnigan rules.[Tenn. Code Ann. § 67-4-2013(b)(2). BNA-CITN TN 8.3.3.4.6.
Texas	Joyce. Texas follows the Joyce rule. [Tex. Tax Code Ann. § 171.103(b).] BNA-CITN TX 6.4.4.3.	Joyce. Texas follows the Joyce rule. Tex. Tax Code Ann. § 171.103(b). BNA-CITN TX 8.3.3.4.6.
Utah	Finnigan. Utah follows the Finnigan rule. Utah Code Ann. § 59-7-317; Utah Admin. Code § R865-6F-24(B). BNA-CITN UT 6.4.4.3.	Finnigan. Utah follows the Finnigan rule. Utah Code Ann. § 59-7-317; Utah Admin. Code § R865-6F-24(B). BNA-CITN UT 8.3.3.4.6.
Vermont	Joyce. Vermont follows the Joyce rule. Vt. Code R. § 1.5862(d)-8(a). BNA-CITN VT 6.4.4.3.	Joyce. Vermont follows the Joyce rule.[Vt. Code R. § 1.5862(d)-8(a).] BNA-CITN VT 8.3.3.4.6.
Virginia	Joyce. Virginia follows the Joyce rule. [Va. Regs. § 10-120-327.] BNA-CITN VA 6.4.4.3.	Joyce. Virginia follows the Joyce rule. [Va. Code Ann. § 58.1-442(B)(2).] BNA-CITN VA 8.3.3.4.6.
Washington	No corporate income tax. Washington does not impose a corporate income tax. BNA-CITN WA 6.4.4.3.	No corporate income tax. Washington does not impose a corporate income tax. BNA-CITN WA 8.3.3.4.6.
West Virginia	Joyce. West Virginia follows the Joyce rule. W.Va. Code R. tit. 110, § 110-24-7.7(d)(2). BNA-CITN WV 6.4.4.3.	Joyce. West Virginia follows the Joyce rule. W.Va. Code R. tit. 110, § 110-24-7.7(d)(2). BNA-CITN WV 8.3.3.4.6.
Wisconsin	Finnigan. Wisconsin follows the Finnigan rule. [Wis. Stat. § 71.255(5)(a).] BNA-CITN WI 6.4.4.3.	Finnigan. Wisconsin follows the Finnigan rule. [Wis. Stat. § 71.255(5)(a); Bloomberg BNA Survey of State Tax Departments.]

Topic	Allocation and Apportionment The Sales Factor Throwback and Throwout Rules Joyce and Finnigan Rules for Combined Reporting	Group Taxation Combined Returns Computation of Combined Taxable Income Apportionment and Allocation Joyce vs. Finnigan
Wyoming	No corporate income tax. Wyoming does not impose a corporate income tax. BNA-CITN WY 6.4.4.3.	No corporate income tax. Wyoming does not impose a corporate income tax. BNA-CITN WY 8.3.3.4.6.

APPENDIX F

**MTC Income & Franchise Tax Uniformity Subcommittee Work Group
Recommendations Regarding Application of the *Joyce* Apportionment Formula
For the MTC Model Uniform Combined Reporting Statute**

I. Introduction:

The MTC's draft model uniform statute for combined reporting incorporates the Joyce method of apportionment. However, the Uniformity Committee has asked that consideration be given to substituting the Finnigan rule, as a means for counteracting tax planning activities that can take advantage of inadequacies in the nexus laws, even in a combined reporting context. For example, if an entity makes sales into Minnesota, and has activities in excess of solicitation in that state, Minnesota sales can be avoided by simply placing the nexus activity in a separate corporation, and asserting that the Minnesota sales are now protected by P.L. 86-272. If the state of origin does not have a "throw back" rule, the sale is not assigned to any taxing state. Because the sum of the apportionment percentages in all states the taxpayer does business does not add up to 100%, a substantial portion of a combined group's income is not subjected to tax in any taxing state. This problem would be vastly compounded under H.R. 3220.

II. Background:

A. Summary Description.

- Joyce

In a nutshell, a state employing the Joyce rule does not consider the sales factor numerator of those members of the combined group that are not subject to taxation when they compute the sales factor percentage. So, for example, assume a California based unitary group has one corporation--Corporation A--that is subject to taxation in Minnesota. However, another member, Corporation B, is not subject to tax in Minnesota, but makes destination sales to customers in Minnesota. Under the Joyce rule, Minnesota would only use Corporation A's sales to apportion income to Corporation A.

- Finnigan

The Finnigan rule uses all sales numerators of members of the combined group to apportion income to a state, regardless of whether each member is subject to taxation in that state. So, considering the example described above, both Corporation A's sales and Corporation B's sales made to customers in Minnesota would be used in determining the apportionment percentage for Corporation A, even though Corporation B is not subject to the Minnesota corporate franchise tax.

B. Case Law.

There are a number of cases governing the Finnigan and Joyce dichotomy. Finnigan/Joyce essentially involves the question on how to determine the California sales factor in context with combined income reporting in California.

In the Appeal of Joyce, Inc., 66 SBE 069 (November 23, 1966), the California State Board of Equalization ("BOE") ruled, inter alia, that Public Law 86-272 prohibited using sales to apportion income to California if the sales were made by a member of a unitary combined group that was exempt from taxation under Public Law 86-272.

In 1988, the BOE ruled in Appeal of Finnigan Corporation, 88 SBE 022 (herein referred to as "Finnigan I") that sales made to customers outside California by a subsidiary of Finnigan Corporation did not have to be "thrown back" to California even though the subsidiary was not subject to taxation in such states. California law used the destination sales method for determining where sales were to be situated. However, California law required that sales were assigned to California if the property was shipped from California and the "taxpayer (was) not taxable in the state of the purchaser." Rev. & Tax. Code § 25135, Subd. (b).

The issue in Finnigan I turned on the question of whether the term "taxpayer" in the "throwback" rule had a different definition than in other parts of the Uniform Division of Income for Purposes Act (UDITPA). The Franchise Tax Board argued that the "throw back" rule's use of the word "taxpayer" referred to each corporation in a combined group, not the combined group.

The BOE ruled that the definition of "taxpayer" applied to the combined unitary group and because the subsidiary of Finnigan Corporation was subject to taxation in the foreign states at issue, the sales were improperly thrown back to California.

This ruling appeared to be inconsistent with the BOE's earlier ruling in Joyce. In 1990, the BOE resolved this inconsistency by overturning Joyce. In Appeal of Finnigan, 88 SBE 022-A (herein Finnigan II), the BOE ruled that its holding in Finnigan I was correct and that the rule established in Joyce was overturned. The BOE noted that the Joyce rule had been the subject of particularly pointed scholarly criticism and that Joyce undermined fundamental unitary theory in two ways. First, it defeated the basic purpose of the sales factor, which is to reflect the market for the unitary business's goods and services. Second, the Joyce rule elevated form over substance by yielding a different apportionment result that was dependant solely on whether the unitary business was conducted by several corporations or through a single corporation.

Following Finnigan II, the application of the rationale of that case to "inbound sales" was considered. The Franchise Tax Board argued that if sales could not be "thrown back" because a member of the unitary group was taxable in the destination state, the same principle should apply to assign sales to California if California was the destination state and if any member of the unitary group was taxable in that state. In The Appeal of NutraSweet, 92 SBE 024, October 29, 1992, the BOE extended Finnigan II to those tax years before Finnigan I and Finnigan II were announced; 1988 and 1990 respectively. NutraSweet had sought application of the Joyce rule to its 1974 through 1977 California returns, arguing that the Joyce rule had been overturned after these returns were filed.

The BOE ruled that the Finnigan rule applied to years prior to the Finnigan II ruling that overturned the Joyce rule.

In April of 1999, the BOE once again reversed its position on the Finnigan/ Joyce issue and prospectively overturned the Finnigan rule in favor of Joyce rule. In the Appeal of Huff Corporation, 99 SBE 005, the BOE stated that, when it adopted the Finnigan rule, it was thought that it would lead to a more theoretically sound application of the unitary method. However, the Finnigan rule had been the subject of academic criticism and the BOE noted that few other taxing states have adopted the Finnigan approach. The BOE noted that,

While there were theoretically good reasons for the initial implementation of the Finnigan/NutraSweet rule, the actual practice has resulted in the taxation of income that would not otherwise be taxed by the state of California. In order to promote uniformity...this Board believes that its pre-Finnigan decision in Joyce is the better law.

The BOE recognized that the reversal of its reversal would be troubling to taxpayers, as well as the FTB. Consequently, the BOE ruled in Huff that the Joyce rule would only apply prospectively for tax years beginning on or after the date of the opinion (April 22, 1999).

In *Citicorp North America, Inc. v. Franchise Tax Board*, 100 Cal. Rptr. 2d 509, October 2, 2000, the California Court of Appeals, affirmed the constitutional validity of the Finnigan rule in upholding, inter alia, a lower court ruling that found that the FTB properly included the California sales of Citicorp's Citibank (South Dakota), in the sales factor, even though the subsidiary had no physical presence in California, and it was not subject to California's corporate franchise or income tax. This ruling was applicable to tax years prior to the BOE's ruling in Huff.

Citibank (South Dakota)'s only office was located in South Dakota. In its complaint, Citicorp North America argued that the Finnigan rule violated the Due Process and Equal Protection Clauses of the United States and California Constitution, and the Commerce Clause of the United States Constitution. The court concluded that of the Finnigan rule was consistent with unitary principles, that its interpretation of the term "taxpayer" was not unreasonable, that there was no conflict with *Current, Inc. v. State Board of Equalization*, 24 Cal.App. 2d 382 (*Current* was a decision that invalidated a statute that imposed a use tax on out-of-state mail-order companies based solely on its acquisition by a corporation with substantial California contacts), and the principles of uniformity do not require uniform acceptance.

In *Deluxe Corp. v. Franchise Tax Board*, the California Court of Appeals also affirmed Finnigan, ruling that the FTB properly included the California sales of Deluxe Corp.'s wholly-owned subsidiaries in the sales factor, even though such subsidiaries did not have nexus in California. Unlike the CitiCorp case, which was a constitutional challenge, the sales at issue in Deluxe were tangible personal property, which raised the Finnigan issue

in the context of arguable protections under P.L. 86-272. However, the Deluxe opinion was not published, and does not constitute citable precedent in California. The court applied the Finnigan rule to those tax years filed prior to the Hufffy ruling, even though at the time of the Deluxe ruling, the BOE had already decided the Hufffy decision rejecting the Finnigan approach.

III. Analysis:

The advantages of adopting the Finnigan rule include:

- Under Finnigan, the business income ultimately apportioned to a state is the same whether an enterprise is conducted in divisional or multicorporate form.
- It prevents tax planning techniques for isolating sales in non-nexus affiliates.
- It helps reduce "no-where" income.
- It reflects the contribution of the market state in the production of income, in addition to manufacturing/production, regardless of whether the legal entity making the sales has nexus in a state.

The disadvantages of adopting the Finnigan rule include:

- It is unclear whether the rule is constitutional. The California Court of Appeals has upheld the constitutionality of the Finnigan rule, but it is not clear whether this rule would be found constitutional in other jurisdictions.
- There is a question of whether the Finnigan rule contravenes Public Law 86-272. Because the word "person" used in P.L. 86-272 is likely to be interpreted as referring to each separate legal entity as opposed to the unitary group (see section 1 of title 1 of the United States Code), application of Finnigan may be unsupported as an attempt by a state to contravene 86-272 and do indirectly what it can not do directly. Under Finnigan, the sum of the taxes ultimately owed to a destination state by all members of the unitary group is exactly the same, whether or not the selling member is exempt under federal law. Thus, it is arguable that Finnigan merely shifts the sales of the exempt entity to a taxable entity, thereby eliminating any benefit of the exemption.
- It may create more litigation. Because it is a more novel method than the Joyce rule, it is likely to produce litigation for a state that adopts the rule. It was the subject of much litigation in California.
- For states that have a throwback rule, it could be detrimental from a revenue perspective because they might not be able to throw back sales to their state if they adopt the Finnigan approach. In enacting the Finnigan rule, states should consider how it might affect their throwback rules.
- It may be inconsistent with the tax treatment required under other combined reporting provisions, such as those applicable to NOLs and credits. To illustrate, a member of a unitary group could have an apportioned share of a loss of a unitary group and a substantial positive amount of nonbusiness income. The combined reporting statute would permit that entity's share of the business loss (and only that share) to be offset against that member's nonbusiness income. Likewise, if a

- member of a unitary group has a positive share of the business income of the group, and a nonbusiness loss, only that member's share of business income of the group may be offset against the member's nonbusiness loss. If the net of gains and losses produce an overall loss, the member has a state source net operating loss, but that loss is available as a deduction in the following year ONLY against that member's apportioned and allocated income in the later year.
- It may be inconsistent with the rationale supporting inclusion of non-corporate income taxpayers (such as insurance companies) in the combined group. A single unitary business may be carried on by many types of business entities acting together, not just corporations and certainly not just corporations that are corporate income taxpayers. It is theoretically correct and, in many states legally acceptable, to require the inclusion of all such business entities, even those that are not corporate income taxpayers, in the combined group in order to properly apportion the income of the entire unitary business. Including the income of a nontaxable member in the combined group should not make that member a "taxpayer" and should not subject that member's income to the corporate income tax. Inclusion should merely provide the income base from which those corporations that are taxable will determine their apportionable share. Indeed, if a combined group of taxpayer members and non-taxpayer members were considered to be one "taxpayer," the effect of such a combination could be viewed as troubling. To illustrate, assume an insurance company had insurance premiums in a state solicited via the Internet and by mail, and further assume that such sales would not have sufficient nexus to impose tax. The insurance company is combined with general corporations taxable in that state. Despite the insurance company's absence of nexus, the sales of the insurance company would be assigned to the numerator of the sales factor of the "group" as a whole, because the group as a whole is considered a "taxpayer." Under the Finnigan method formerly used in California, once the income is apportioned to the state for the group as a whole, it is then subdivided between the taxpayer members that actually have nexus in the state for imposition of tax. Thus, the taxpayer general corporate members will have a tax liability in part measured by the sales of the insurance company.
 - It may be inconsistent with the treatment of the separate group members as separate legal entities and as individual taxpayers.
 - It may be a departure from the theory of intrastate apportionment that each member's factors produce state source income in proportion to each member's share of the factors of the group as a whole.
 - It may be inconsistent with separate entity tax liability. Once tax is imposed upon a unitary member, the liability is that of the specific member. If the tax is unpaid, collection of that liability is limited to that particular member's assets. If a unitary group were considered as a single taxable entity, that would imply that assets of any member, located in any state or country, could be reached to satisfy an unpaid state tax deficiency of any member.
 - There may be other solutions to the nexus problem that we should consider as alternatives to implementing Finnigan. For example, throwback rules.

IV. Conclusion

The Work Group recommends the model statute retain the Joyce rule. States that adopt the model statute should also consider a throwback provision. The addition of a throwback provision would resolve some of the tax avoidance strategies used under the Joyce rule, yet avoid the problems identified with the Finnigan rule.



Multistate Tax Commission Memorandum

States Working Together Since 1967 . . . To Preserve Federalism and Tax Fairness

To: Income and Franchise Tax Uniformity Subcommittee
From: Shirley Sicilian, Deputy General Counsel
Date: December 15, 2003 **DRAFT – FOR DISCUSSION PURPOSES ONLY**
Subject: Combined Reporting: 1) definition of common terms, and 2) interaction with *Joyce* and *Finnigan* rules

At its October meeting in Salt Lake City, the Income and Franchise Tax Uniformity Subcommittee determined it would meet via teleconference in mid-December to continue development of uniform rules for combined reporting. The teleconference agenda includes: 1) definitions of common terms, and 2) interaction of combined reporting with *Joyce* and *Finnigan* rules.

I. Definitions of Common Terms

A. *Separate Return*

Under the separate return filing method, each affiliated entity that has nexus with the taxing state separately reports its income. The income, loss carryforwards, credits, etc. for each is determined on a stand-alone basis. If any of the entities operate in more than one state, each of those entities will apportion its stand alone income based on its stand alone apportionment factors, i.e., the denominators will include the property, payroll, and sales only for that stand-alone entity. For example, in a state which employs the equal weighted three factor formula, three related corporations - A, B, and C - could file separately and report state taxable income as follows:

$$Asinc_{sr} = (Aspty/Atpty + Aspri/Atpri + Assls/Atsls) \times 1/3 \times Atinc$$

$$Bsinc_{sr} = (Bspty/Btpty + Bsprl/Btpri + Bssls/Btsls) \times 1/3 \times Btinc$$

C, a non-jurisdictional entity, would not file a report

Where:

Xsinc_{sr} = state taxable income of Corp X filing a separate return

Xtinc = total taxable income of Corp X

Xspty = in-state property of Corp X

Xtpty = total property of Corp X

Xsprl = in-state payroll of Corp X

Xtpri = total payroll of Corp X

Xssls = in-state sales of Corp X

Xtsls = total sales of Corp X

B. Combined Report

The combined report is a method of sourcing income among affiliated¹, unitary² entities. Although entities included in a combined report must be affiliated and unitary, they need not all have nexus³ with the state. The purpose of the combined report is to determine the state taxable income of those members of the group which do have nexus with the state by apportioning the income of the entire group on the basis of combined apportionment factors. The denominator of the combined apportionment factors will include the property, payroll and sales of the entire unitary group. Whether the numerator includes the factors of all members or only jurisdictional members will depend on whether the state treats the group as a single taxpayer or treats each member of the group as an individual taxpayer, i.e. on whether the state adheres to the *Finnigan* or the *Joyce* rule (see below). Using the example above, three unitary group members would file a combined report in a *Joyce* state as follows:

$$\text{UGsinc} = \frac{[(\text{Aspty} + \text{Bspty})/(\text{Atpty} + \text{Btpty} + \text{Ctpty}) + (\text{Asprl} + \text{Bsprl})/(\text{Atprl} + \text{Btprl} + \text{Ctprl}) + (\text{Assls} + \text{Bspls})/(\text{Atpls} + \text{Btpls} + \text{Ctpls})]}{(\text{Atinc} + \text{Btinc} + \text{Ctinc})} \times 1/3$$

Where, in addition to the key above:

$$\text{UGsinc} = \text{state taxable income for the entire unitary group}$$

The amount of state taxable income generated under a combined reporting method will not be the same as the sum of the state taxable income generated by the jurisdictional unitary entities under the separate return method. That is, $\text{UGinc} \neq \text{Asinc}_{\text{sr}} + \text{Bsinc}_{\text{sr}}$. This is because the unitary income and factors of the non-jurisdictional⁴ member, C, is included in the apportionment calculation under combined reporting, while C's income is not subject to apportionment under separate reporting. Whether combined reporting will increase or decrease the total state taxable income of a unitary group depends on the relative profitability and apportionment factors of the non-jurisdictional members.

C. Intra-State Apportionment

States often have special rules limiting the ability of the entire combined group to benefit from loss carryforwards, credits etc. which are attributable to a specific member of the group. For example, a research and development credit earned by Corp A would be limited to offsetting Corp A's state taxable income, and could not be used against the state taxable income of the combined group as a whole. To apply these rules, the state taxable income attributable to each group member with nexus must be broken back out from the total income apportioned to the state. The amount of state taxable income assigned to a jurisdictional entity is determined using the same apportionment factor (in this case the equal weighted three factor formula), with only that entity's factors included in the numerator, as follows:

¹ Most states require "ownership or control" of more than 50% of the stock in the affiliated corporation in order for it to be included in a combined report.

² A unitary business is characterized by a "flow of value" among the entities included.

³ A combined report may include entities which lack of nexus due to either constitutional considerations or to PL86-272.

⁴ The non-jurisdictional entity may lack nexus due to either constitutional considerations or to PL86-272.

$$Asinc_{cr} = [Aspty/(Atpty+Btpty+Ctpty)+ Asprl/(Atprl +Btprl+ Ctprl)+ Assls/(Atsls+Btsls+Ctsls)] \times 1/3 \times (Atinc+Btinc+Ctinc)$$

$$Bsinc_{cr} = [Bspty/(Atpty+Btpty+Ctpty)+ Bsprl/(Atprl +Btprl+ Ctprl)+ Bssls/(Atsls+Btsls+Ctsls)] \times 1/3 \times (Atinc+Btinc+Ctinc)$$

Corp C, the non-jurisdictional corporation, would not file a return

Where, in addition to the key above:

$$Xsinc_{cr} = \text{state taxable income apportioned to Corp X filing a combined return}$$

In a state that follows *Joyce*, the sum of state taxable income assigned to each jurisdictional entity using the formula above will equal the total state taxable income for the group, determined using the formula in section B above. That is, $Asinc + Bsinc = UGsinc$.

In a *Finnigan* state, the sum of the jurisdictional entities' state taxable income determined under the formula above would fall short of the total state taxable income for the group. In order to fully apportion the group's state taxable income across the jurisdictional entities required to file a return, each entity must report its state taxable income as determined using the formula above, plus a share of the shortfall. A share of the shortfall can be apportioned to each of the jurisdictional entities based on the relative percentage of their state apportionment factors.

$$Asf = [Asinc/(Asinc+Bsinc+Ccind)] / [Asinc/(Asinc+Bsinc+Ccind) + Bsinc/(Asinc+Bsinc+Ccind)] \times [UGsinc - (Asinc+Bsinc)]$$

$$Bsf = [Bsinc/(Asinc+Bsinc+Ccind)] / [Asinc/(Asinc+Bsinc+Ccind) + Bsinc/(Asinc+Bsinc+Ccind)] \times [UGsinc - (Asinc+Bsinc)]$$

Where Xsf = the amount of the shortfall assigned to company X

D. Consolidated Return

A consolidated return is a joint filing of a single return by a group of affiliated entities. Entities filing a consolidated return are generally not required to be unitary. Beyond those basic statements, there is a great deal of variation across the states. Some states allow affiliated, non-unitary entities with nexus to add together their separately determined state tax liability on a consolidated return – “separate company method.” Some states follow the federal rules for consolidation, and use consolidated taxable income and the combined in-state apportionment – “federal consolidated method.”⁵ Some states using the federal consolidated method may apply the rules to only those entities with nexus.

⁵ For federal income tax purposes, inclusion in a consolidated return requires ownership of 80% or more of the affiliate's stock and that the United States have jurisdiction to tax all of the income of the entities on a residence basis. Double taxation is avoided by allowing a credit for taxes paid to other countries where the income is sourced, rather than by apportionment.

Other states may apply the rules to all members of a federal group, whether or not they have nexus.

E. World Wide Combination

The term “world wide combination” refers to a type of membership requirement for a combined group. “World wide” combined reporting includes *all* affiliates participating in the group’s unitary business, including foreign affiliates. World wide combination has been recognized as conceptually superior to other reporting methods, and the U.S. Supreme Court has upheld its imposition.⁶ However, only one state – Alaska - imposes world wide combination as the exclusive reporting option, and that requirement applies to only unitary taxpayers engaged in the production or transportation of oil and gas. California, North Dakota, Montana and Idaho require world wide combination of all unitary affiliates, but allow a water’s edge election (see “*water’s edge*,” below). North Dakota imposes a surtax on taxpayers making the water’s edge election (2003 H 1471).

F. Water’s Edge Combination.

“Water’s edge” reporting is an alternative to “world wide.” Under the water’s edge approach, a state requires combination of only those unitary affiliates incorporated in the United States. Of the 16 states that require combined reporting, all allow (or require) water’s edge filing, with the exception of Alaska’s requirements for their oil and gas taxpayers. Some states will include foreign affiliates if more than 80% of their property and payroll are in the U.S.

G. Water’s Edge plus Tax Haven Combination

A third alternative combination could be described as “water’s edge plus tax haven.” During its 2003 legislative session, Montana enacted HB 721⁷, which requires that in addition to the “water’s edge” combined group, a corporation’s return include the income and apportionment factors for any unitary corporation incorporated in a “tax haven.” The legislation did not define “tax haven” but listed 37 jurisdictions and requires the revenue department to report biennially with an update of countries that may be considered a tax havens.

A 1998 Organization for Economic Co-operation and Development (OECD) Report⁸ described four key factors for identifying a tax haven:

- 1) there is no or nominal tax on the relevant income (from geographically mobile financial and other service activities);
- 2) there is no effective exchange of information with respect to the regime;

⁶ *Container*, 463 U.S. 159, 103 S.Ct. 2983; *Barclays Bank PLC v. Franchise Tax Bd. Of California*, 512 U.S. 298, 114 S.Ct. 2268 (1994).

⁷ Montana 2003 Session HB 721 <http://data.opi.state.mt.us/bills/2003/billhtml/HB0721.htm>

⁸ *Harmful Tax Competition: An Emerging Global Issue*; Report to the Organization for Economic Co-operation and Development (Approved April, 1998) <http://www.oecd.org/dataoecd/33/0/1904176.pdf>

- 3) the jurisdiction's regimes lack transparency e.g. the details of the regime or its application are not apparent, or there is inadequate regulatory supervision or financial disclosure; and
- 4) the jurisdiction facilitates the establishment of foreign owned entities without the need for a local substantive presence or prohibits these entities from having any commercial impact on the local economy.

The Report adds that whether a jurisdiction meets the tax haven criteria should be determined based upon all the facts and circumstances, including whether the jurisdiction has a significant untaxed offshore financial/other services sector relative to its overall economy.

II. Interaction of Combined Reporting with *Joyce* and *Finnegan* Rules

One policy question that arises with combined reporting is whether the non-jurisdictional group members' in-state property, payroll and sales should be included in the numerators of the state's apportionment factors. Because the existence of property or payroll in a state generally creates nexus, while the existence of sales in a state may be protected under PL86-272 and thus may not create nexus, the issue often comes down to whether non-jurisdictional (PL86-272 protected) members' in-state sales will be included in the numerator of the state's sales factor. A related question is whether the sales throwback provision is triggered only if none of the group members has nexus with the destination state, or on a member by member basis. The answers should depend on whether the group is the "taxpayer," or the individual members of the group are the "taxpayers."

In *Joyce*⁹, the California State Board of Equalization (BOE) held that although *Joyce* was part of a unitary business, some members of which conducted business in California, receipts from goods shipped to its California customers could not be included in the numerator of the California sales factor because *Joyce*, itself, was protected from taxation under PL86-272. If a state follows *Joyce*, it effectively treats each member as a separate taxpayer. Receipts from sales by a member will not be included in the numerator of the state's sales factor unless the member itself is taxable in the state, even if other members of the unitary group are taxable in the state. Thus, the state's apportionment factor numerators include only payroll, property and sales located in the state for the jurisdictional members of the unitary group. Throwback is triggered on a member by member basis (i.e. if the jurisdictional member does not have nexus on a stand-alone basis with the destination state, sales to that state may be thrown back regardless of whether other members have nexus with that destination state).

In *Finnigan*¹⁰, the California BOE held that where one member of a California based combined group was taxable in Arizona, the Arizona sales of another member that was not taxable in Arizona because of PL 86-272 could not be thrown back to California. The

⁹ *Appeal of Joyce, Inc.*, Cal. State Bd. Of Equal., No.66-SBE-069 (Nov. 23, 1966).

¹⁰ *Appeal of Finnigan Corp.*, Cal. State Bd of Equal., No.88 SBE-022A (Aug. 25, 1988), reh'g denied, (Jan. 24, 1990).

flip side of the ruling, of course, is that the factors of a non-jurisdictional member of a unitary group may be included in a combined report of the unitary group in a state where other members of the group have nexus. If a state follows *Finnigan*, it effectively treats the entire group as a single taxpayer. Receipts from sales by a member will be included in the numerator of the state's sales factor because at least one other member of the group is taxable by the state. The state's apportionment factor numerators include all property, payroll and sales located in the state of the entire unitary group, non-jurisdictional as well as jurisdictional members. Throwback would only be triggered if none of the group members has nexus with the destination state.

The distinction between *Joyce* and *Finnigan* can be shown formulaically as follows:

$$UG_{sinc} = \frac{[(As_{pty}+Bs_{pty}+Cs_{pty})/(At_{pty}+Bt_{pty}+Ct_{pty}) + (As_{prl}+Bs_{prl}+Cs_{prl})/(At_{prl}+Bt_{prl}+Ct_{prl}) + (As_{sls}+Bs_{sls}+Cs_{sls})/(At_{sls}+Bt_{sls}+Ct_{sls})]}{(At_{inc}+Bt_{inc}+Ct_{inc})} \times \frac{1}{3}$$

Where *Finnigan* states will include the bold italicized terms and *Joyce* states will not.

APPENDIX G

Concurring Opinion >

Pagination
* N.Y.3d
** N.Y.S.2d
*** N.E.2d
**** BL

Court of Appeals of the State of New York.

In the Matter of DISNEY ENTERPRISES, INC., et al., Appellants, v. TAX APPEALS TRIBUNAL OF THE STATE OF NEW YORK et al., Respondents.

No. 37.

Argued February 13, 2008.

decided March 25, 2008.

APPEAL, on constitutional grounds, from a judgment of the Appellate Division of the Supreme Court in the Third Judicial Department, entered March 1, 2007, in a proceeding pursuant to CPLR article 78 (initiated in the Appellate Division pursuant to Tax Law § 2016). The Appellate Division confirmed a determination of respondent Tax Appeals Tribunal which had denied petitioners' request for a refund of corporate franchise tax imposed under Tax Law article 9-A and dismissed the petition.

Matter of Disney Enters., Inc. v Tax Appeals Trib. of State of N.Y., 40 AD3d 49, affirmed. [*393]

[**88] [***1030] *Morrison & Foerster LLP*, New York City (*Paul H. Frankel, Craig B. Fields and Roberta Moseley Nero* of counsel), *Michael H. Salama*, Burbank, California, and *Brandee A. Tilman* for appellants. I. Questions of fact are not reviewable by this Court. (*Matter of Gillette Co. v State Tax Commn.*, 56 AD2d 475, 45 NY2d 846; *Matter of Industrial Liaison Comm. of Niagara Falls Area Chamber of Commerce v Williams*, 72 NY2d 137.) II. The opinion disregards the Tax Appeals Tribunal's finding that Buena Vista Home Video is a nontaxpayer. (*Wisconsin Dept. of Revenue v William Wrigley, Jr., Co.*, 505 US 214.) III. The inclusion of the New York destination sales of a nontaxpayer in the numerator of the New York receipts factor of a combined group is the taxation of the nontaxpayer's income and as such is prohibited by the Supremacy Clause of the US Constitution and Public Law 86-272. (*Shell Oil Co. v Iowa Dept. of Revenue*, 488 US 19; *Mobil Oil Corp. v Commissioner of Taxes of Vt.*, 445 US 425; *Container Corp. of America v Franchise Tax Bd.*, 463 US 159; *Hans Rees' Sons, Inc. v North Carolina ex rel. Maxwell*, 283 US 123; *Bass, Ratcliff & Gretton, Ltd. v State Tax Comm'n*, 266 US 271; *Underwood Typewriter Co. v Chamberlain*, 254 US 113; *Wisconsin Dept. of Revenue v William Wrigley, Jr., Co.*, 505 US 214; *Aloha Airlines, Inc. v Director of Taxation of Haw.*, 464 US 7.) IV The inclusion of Buena Vista Home Video's New York destination sales in the numerator of the combined group's sales factor results in the taxation of extraterritorial values in violation of the Due Process Clause and Commerce Clause of the United States Constitution. (*Mobil Oil Corp. v Commissioner of Taxes of Vt.*, 445 US 425 [*394]; *Complete Auto Transit, Inc. v Brady*, 430 US 274.)

Andrew M. Cuomo, Attorney General, Albany (*Robert M. Goldfarb, Barbara D. Underwood and Andrew D. Bing* of counsel), for Commissioner of Taxation and Finance, respondent. I. The inclusion of Buena Vista Home Video's New York sales receipts in the business allocation percentage used to allocate a portion of petitioner's combined income to New York does not violate Public Law 86-272. (*Department of Revenue of Ore. v ACF Industries, Inc.*, 510 US 332; *Rice v Santa Fe Elevator Corp.*, 331 US 218; *Heublein, Inc. v South Carolina Tax Comm'n*, 409 US 275; *United States v Bass*, 404 US 336; *Lorillard Tobacco Co. v Roth*, 99 NY2d 316; *Wisconsin Dept. of Revenue v William Wrigley, Jr., Co.*, 505 US 214; *Barclays Bank PLC v Franchise Tax Bd. of Cal.*, 512 US 298; *Shell Oil Co. v Iowa Dept. of Revenue*, 488 US 19; *Container Corp. of America v Franchise Tax Bd.*, 463 US 159; *Exxon Corp. v Department of Revenue of Wis.*, 447 US 207.) II. The [****2] inclusion of Buena Visa Home Video's New York sales receipts in the business allocation percentage used to allocate petitioner's combined income to New York does not violate the Due

Process or the Commerce Clause. (*Matter of Khan v New York State Dept. of Health*, 96 NY2d 879; *Container Corp. of America v Franchise Tax Bd.*, 463 US 159; *Barclays Bank PLC v Franchise Tax Bd. of Cal.*, 512 US 298; *Complete Auto Transit, Inc. v Brady*, 430 US 274; *Exxon Corp. v Department of Revenue of Wis.*, 447 US 207.)

Before: Judges CIPARICK, GRAFFEO, READ, PIGOTT and JONES concur with Chief Judge KAYE; Judge SMITH concurs in result in a separate opinion.

OPINION OF THE COURT

Chief Judge KAYE.

This appeal tests the validity, under federal law, of New York's franchise tax apportionment formula.

Petitioner, Disney Enterprises, Inc., is a worldwide entertainment conglomerate with hundreds of parents, subsidiaries and affiliates. Disney conducts general operations in three interrelated business segments pertinent to the present appeal: theme parks and resorts, filmed entertainment and consumer products. Its consumer products segment licenses and distributes merchandise (apparel, toys, gifts, housewares) and publications (books, magazines, comic books). It also licenses its properties for promotional use to, for example, soft drink companies and fast food chains. Disney receives royalties from these licensing activities, both tangible (from manufactured products) and intangible (from copyrights). Through its Synergy Group, Disney [*395] coordinates the three business segments for cross-promotional purposes, parlaying the success of a movie or Broadway show (such as "The Little Mermaid") into sales of its licensed products. These cross-promotional activities (or synergies) create flows of value among Disney's interrelated corporate subsidiaries and affiliates.

For corporate franchise tax purposes, New York permits or requires^[fn1] related corporations to report their income on a "combined basis" where "there are substantial intercorporate transactions among [****89**] [*****1031**] the corporations" (see 20 NYCRR 6-2.3 [a]), on the theory that if the members of the group filed separately the financial activities of the group as a whole would be distorted. Combined reporting treats the unitary business as a single, taxable entity, thus the net income of the combined group forms the basis for calculation of the percentage of income taxable by the state. To determine the portion of net income that can be allocated to the state, New York uses an apportionment formula that multiplies the taxpayer's combined worldwide business income by a business allocation percentage (BAP) based upon the New York percentages of the group's overall property, receipts and payroll (Tax Law § 210 [3] [a]). The three percentages are then added together, divided by the number of percentages overall^[fn2] (Tax Law § 210 [4]) and multiplied by the tax rate. A taxpayer calculates the receipts factor — the focus of this appeal — by:

"(2) ascertaining the percentage which the receipts of the taxpayer, computed on the cash or accrual basis according to the method of accounting used in the computation of its [******3**] entire net income, arising during such period from

"(A) sales of its tangible personal property where shipments are made to points within this state, . . .

"(D) all other business receipts earned within the state, bear to the total amount of the taxpayer's receipts, similarly computed, arising during such period from all sales of its tangible personal property, [***396**] services, rentals, royalties, . . . and all other business transactions, whether within or without the state" (Tax Law § 210 [3] [a]).

Thus, the New York percentage is calculated by computing the combined New York totals for the factor (the numerator) and dividing them by the worldwide totals (the denominator).

During relevant years, Disney filed combined reports for certain of its corporate subsidiaries, including Buena Vista Home Video (Video), the subject of the present litigation. For tax years 1990, 1991 and 1992, Video filed separately from the combined group.^[fn3] Although it had \$662,038,872 in gross receipts in 1990 and large sales shipped to points within New York State, Video reported a fixed dollar minimum tax due of \$1,500 and a New York

allocation of 0%. It reported the same minimum tax due and 0% New York allocation for years 1991, when it had \$989,510,226 in gross receipts, and 1992, when it had \$1,372,034,743 in gross receipts.

For tax year 1993, Disney sought permission to add certain subsidiaries to its combined report, among them Video, stating that the company believed that distortion of the current combined group's activities was present due to the benefits of the "Disney synergy," permeating "virtually all of the inextricably connected entities" — including the proposed additions — and creating substantial value that could not be objectively quantified for each of the associated companies. In support of its request, Disney listed six examples of unitary activities that originated from the motion picture "Beauty and the Beast." Animation for the feature was done at its Disney-MGM Studios theme park facilities. Buena Vista Pictures, its distribution company, handled development of theatrical and television advertising trailers and [**90] [***1032] joint advertising arrangements with promotional partners such as Burger King. The Disney Channel televised "Be Our Guest: The Making of Beauty and the Beast," while Buena Vista Television issued a special featuring Angela Lansbury singing "Beauty and the Beast." Video released the home video "The Jungle Book," which included a trailer segment from "Be Our Guest: The Making of Beauty and the Beast," and later released the home video of "Beauty and the Beast."

The Division granted Disney's request, and in 1993-1995 Video was included in the Disney group's combined report. [*397] Video, however, continued to report a fixed dollar minimum tax of \$1,500 and a 0% New York allocation percentage, and reported none of its \$1,450,727,704 in gross receipts for 1993, its \$1,802,840,975 in gross receipts for 1994 or its \$2,456,596,414 in gross receipts for 1995 as "sales of tangible personal property shipped to points within New York State," although, again, Video had large receipts from property [****4] shipped to points within the state (Video's New York payroll and property factor calculations were negligible).

In omitting Video's destination sales in New York from its combined receipts calculation, Disney relied on a federal exemption that shielded Video, it claimed, from New York franchise income taxation other than for the fixed \$1,500 minimum. *Section 101* of Public Law 86-272 (73 US Stat 555) provides:

"(a) No State, or political subdivision thereof, shall have power to impose, for any taxable year ending after [September 14, 1959], a net income tax on the income derived within such State by any person from interstate commerce if the only business activities within such State by or on behalf of such person during such taxable year are either, or both, of the following:

"(1) the solicitation of orders by such person, or his representative, in such State for sales of tangible personal property, which orders are sent outside the State for approval or rejection, and, if approved, are filled by shipment or delivery from a point outside the State; and

"(2) the solicitation of orders by such person, or his representative, in such State in the name of or for the benefit of a prospective customer of such person, if orders by such customer to such person to enable such customer to fill orders resulting from such solicitation are orders described in paragraph (1) . . .

"(c) For purposes of subsection (a) of this section, a person shall not be considered to have engaged in business activities within a State during any taxable year merely by reason of sales in such State, or the [*398] solicitation of orders for sales in such State" (codified as 15 USC § 381 [a], [c]).[fn4]

After audit, the New York State Department of Taxation and Finance adjusted Disney's business allocation percentage for years 1990-1995 to reflect the companies that were included in or should have been included in the combined group. It increased the numerators in each year's receipts factors, representing combined New York destination sales, to include Video's destination sales for tax years 1990-1995. By letter dated October 5, 2000, the Division of Taxation advised Disney that its audit had resulted in an increase of tax liability in the amount of \$1,349,640. [**91] [***1033]

Disney claimed that Video was not subject to taxation under Tax Law article 9-A because its New York activities did not amount to more than "solicitation." Video's sole New York activities, it maintained, were the sale of movie

cassettes to third parties — large-scale retailers such as Wal-Mart, Toys R Us and Blockbuster — for purposes of resale, and to wholesalers. Although other Disney entities such as the Disney Store promoted Video's products in, for example, "cash-wrap displays" at cashier's counters, Video itself only permitted salespeople to solicit business from New York customers, not to take orders, collect money or accept returned items, and Video did not own or rent any property in New York. When it was included as a member of the combined group, therefore, Disney determined that Video's New York receipts could not be counted in tabulating the combined receipts factor under New York's franchise [****5] tax apportionment formula as Video was a nontaxpayer pursuant to Public Law 86-272.

On November 30, 2000, the Department of Taxation and Finance issued a notice of deficiency asserting total taxes due for the six years at issue, plus interest, of \$1,359,659.42. On Disney's petition to the Division of Tax Appeals, the administrative law judge sustained the notice, finding that "[i]t simply cannot be concluded that the *only* business activit[y] within New York . . . by *or on behalf of* [Video] was the solicitation of orders for sales of tangible personal property." To hold otherwise would be to ignore the "inextricable relationship to petitioner's unitary business" and the "extraordinary synergies" among members of the combined Disney group involved in the retailing [*399] of consumer products. The Tax Appeals Tribunal affirmed, emphasizing that as "[t]he BAP . . . determines the tax liability of the combined group's taxpayer members," inclusion of the sales in the combined group's numerator did not violate Public Law 86-272. The Appellate Division confirmed the determination of the Tax Appeals Tribunal and dismissed the petition. We now affirm.

Analysis

A. Is the Formula as Applied to the Combined Group Imposition of a Tax on Video?

As a threshold issue, we must determine whether the Department of Taxation and Finance's inclusion of Video's income in its apportionment formula when determining the combined group's taxable New York income is, in fact, a tax. We agree with the Appellate Division that by "including Video's New York sales receipts in the numerator of the business allocation percentage, the Department is not imposing a tax upon Video. It is attempting to best measure the combined group's taxable in-state activities" (*Matter of Disney Enters., Inc. v Tax Appeals Trib. of State of N.Y.*, 40 AD3d 49, 52 [2007]).

A state may require combined reporting when there is a "unitary business," or a group of companies benefitting from "functional integration, centralization of management, and economies of scale" (*Container Corp. of America v Franchise Tax Bd.*, 463 US 159, 179 [1983], quoting *F. W. Woolworth Co. v Taxation & Revenue Dept. of KM.*, 458 US 354, 364 [1982]). New York employs combined reporting to "avoid distortion of and more realistically portray the true income of closely related businesses" (*Matter of Standard Mfg. Co. v Tax Commn. of State of N.Y.*, 114 AD2d 138, 140 [3d Dept 1986], *affd for reasons stated* 69 NY2d 635 [1986]) regardless of where they are geographically situated. A [**92] [***1034] combined group may include a corporation not individually subject to tax where it is "necessary to properly reflect the tax liability of one or more taxpayers included in the group" due to "substantial intercorporate transactions" or "some agreement, understanding, arrangement or transaction whereby the activity, business, income or capital of any taxpayer is improperly or inaccurately reflected" (*see* 20 NYCRR 6-2.5 [a]; Tax Law § 211 [4]).

Once this tax base is determined, an apportionment formula is used to allocate the correct geographical, or in-state percentage of income attributable to the group, by "applying the apportionment [*400] factors of the entire unitary business to the taxable net income of the [****6] unitary business" (1 Hellerstein and Hellerstein, *State Taxation* ¶ 8.11 [1] [Warren, Gorham & Lamont, 3d ed 2007] [hereinafter *State Taxation*]). New York, during the tax years at issue, used a weighted three-factor apportionment formula to determine what portion of a taxpayer's income was attributable to in-state business. After apportioning the unitary group's income pursuant to this formula, the Division attributed the apportioned New York income (including the income of the nontaxable members) to the taxable members of the group. Thus, no New York income or New York tax was attributed to or imposed on a nontaxpayer (*see* *State Taxation* ¶ 9.18 [1] [a] [ii]).

It is well settled that, when apportioning a group's in-state taxable income, a state may look beyond its borders and take into account income of companies not subject to its jurisdiction (*see Barclays Bank PLC v Franchise Tax Bd. of Cal.*, 512 US 298, 311-312 n 10 [1994] [finding nothing to suggest that in approximating taxpayers' income, California may not "reference the income of corporations worldwide with whom those taxpayers are closely intertwined"]; *Container Corp.*, 463 US at 165). In doing so, the state is not deemed to have taxed that income but instead to have used it to determine the tax base fairly attributable to the group as a whole (*see Shell Oil Co. v Iowa Dept. of Revenue*, 488 US 19, 30 [1988] [noting that "income that is included in the preapportionment tax base is not, by virtue of that inclusion, taxed by the State"]).

Acknowledging this authority, Disney maintains that the inclusion of Video's sales in the numerator of the apportionment formula — as opposed to the denominator or the multiplier — is the key to its invalidity, and amounts to imposition of a tax on Video. As the *Shell Oil* Court said, "the function of an apportionment formula is to determine the portion of a unitary business' income that can be fairly attributed to [the company's] in-state activities" (*id.* at 31). The New York Department of Taxation and Finance appears to have done precisely that.

Clearly, including Video's income in that of the combined group in the numerator — the part of the equation that, in relation to worldwide sales, forms the basis for the unitary group's New York taxation — increases the Disney group's overall New York tax liability. This does not, however, make it a tax on Video. This Court has recognized the distinction between inclusion of nontaxable income in a formula used as a basis for imposition of [*401] tax and the tax itself (*see Brady v State of New York*, 80 NY2d 596, 604 [1992] ["(w)hen the State levies taxes within its authority, `property not itself taxable can be used as a measure of the tax imposed'" without amounting to a tax on the foreign property]). [**93] [***1035]

The United States Supreme Court also has recognized the distinction (*see Maxwell v Bugbee*, 250 US 525, 535 [1919] [tax was imposed only upon New Jersey property although apportionment formula considered ratio between nonresident's instate property and entire estate]; *Great Atlantic & Pacific Tea Co. v Grosjean*, 301 US 412, 425 [1937] [state tax classification that considered "advantages and capacities" of company's membership in larger multi-state chain "is not in legal effect [****7] the taxation of property or privileges possessed or enjoyed by the taxpayer beyond the borders of the state"]). *Shell Oil* does not hold otherwise especially where, as here, the income is reasonably attributable to New York (*see Moorman Mfg. Co. v Bair*, 437 US 267, 269 [1978]).[fn5]

Indeed, the conceptual basis for combined reporting supports — virtually requires — a distinction between tax apportionment formulas and taxation. The purpose of unitary reporting is to reflect the economic reality of the group as a whole, taking into account multi-jurisdictional, often worldwide, economic activity. Unitary reporting was intended to relieve taxpayers from accounting methods that failed to account for overlap in flows of value, and substitute methods capable of accommodating reciprocities. As Justice Brennan explained:

"The unitary business/formula apportionment method is a very different approach to the problem of taxing businesses operating in more than one jurisdiction. It rejects geographical or transactional accounting, and instead calculates the local tax base by first defining the scope of the `unitary business' [*402] of which the taxed enterprise's activities in the taxing jurisdiction form one part, and then apportioning the total income of that `unitary business' between the taxing jurisdiction and the rest of the world on the basis of a formula taking into account objective measures of the corporation's activities within and without the jurisdiction" (*Container Corp.*, 463 US at 165 [1983]).

If there exist synergies between companies to such a degree that individual corporate receipts cannot be reported without distortion, then the group is conceptually a unified entity with regard to calculating its taxable New York income. As such, it would be unrealistic to require combined group reporting for purposes of achieving economic reality and then parse out individual company receipts when apportioning taxable income. How could the Department of Taxation and Finance determine how much, if any, of Video's New York income from "Beauty and the Beast" should be ascribed to MGM Studios, the animators, to Buena Vista Pictures, marketers and distributors, or to Buena Vista Television, one of its promoters? Certainly, each group member accounts for its own receipts; combined reporting was not instituted because of corporate inability to tabulate [**94] [***1036] individual sales, but because of the distortion —

often to the detriment of the taxpayer, such as the situation here — that resulted from separate taxation on such sales. The Disney combined group's tax would be equally distorted were it to disregard the millions of dollars in Video's New York destination sales achieved through the group's cross-promotional activities.

Therefore, with regard to Disney's combined activities during the relevant tax period, the evaluation of which falls under the Tribunal's special expertise, we defer to its determination that "inclusion of [Video's] sales in the numerator of the receipts factor is necessary to arrive at the appropriate business allocation percentage" ([****8] see *Matter of Industrial Liaison Comm. of Niagara Falls Area Chamber of Commerce v Williams*, 72 NY2d 137, 144 [1988]) and does not amount to a tax on Video.

B. The Impact of Public Law 86-272

While concluding that the apportionment formula represented not a tax on Video but a reflection of Disney's economic reality, the Appellate Division additionally found no violation of Public Law 86-272 on the ground that the New York activities of members of the unitary group fall within the "on behalf of language of the statute (*Matter of Disney*, 40 AD3d at 53). We [*403] conclude, one step earlier, that the "person" referred to in Public Law 86-272 is Disney, not Video, and we do not reach the "on behalf of" language of the statute.

We begin our reading of Public Law 86-272 with the "presumption that Congress does not intend to supplant state law" (*Balbuena v IDR Realty LLC*, 6 NY3d 338, 356 [2006]). Where a federal law treads on a traditional state power, this presumption is especially strong, and is overcome only where the statute evidences that preemption is "the clear and manifest purpose of Congress" (*New York State Conference of Blue Cross & Blue Shield Plans v Travelers Ins. Co.*, 514 US 645, 655 [1995], quoting *Rice v Santa Fe Elevator Corp.*, 331 US 218, 230 [1947]). As this Court has long held that the power to tax is such a traditional state power (see *People v Adirondack Ry. Co.*, 160 NY 225 [1899]), we will not, "absent unambiguous evidence, infer a scope of pre-emption beyond that which clearly is mandated by Congress' language" (*Cipollone v Liggett Group, Inc.*, 505 US 504, 533 [1992]).

Section 101 (a) of Public Law 86-272 provides that "[n]o State . . . shall have power to impose . . . a net income tax on the income derived within such State" if "the only business activities within such State by or on behalf of such person during such taxable year are . . . the solicitation of orders." The statute, therefore, creates a tax exemption for a "person" whose in-state activities do not exceed solicitation. A "person" is defined to include "corporations, companies, associations, firms, partnerships, societies, and joint stock companies, as well as individuals" (1 USC § 1; *S Rep 86-658*, 86th Cong, 1st Sess, reprinted in 1959 US Code Cong & Admin News, at 2548). As such, it is reasonable to conclude that the unitary group, not Video alone, is a "person" for purposes of the statute (see *Airborne Nav. Corp. v Arizona Dept. of Revenue*, 1987 Ariz Tax LEXIS 34, *6 [Bd of Tax App]). This approach is consistent with the concept of unitary reporting in considering the group to be "one entity" for franchise income taxation. No authority persuades us otherwise. [**95] [***1037]

Legislative history surrounding Public Law 86-272 sheds no light on the intended scope of the word "person" to describe the relevant entity, or what activities "on behalf of a related company would take the latter outside of the exemption. It does, however, make clear that the statute should be read narrowly.

The statute was enacted in 1959 — nearly half a century ago — in response to the Supreme Court's holding in *Northwestern States Portland Cement Co. v Minnesota* [*404] that "net income from the interstate operations of a foreign corporation may be subjected to state taxation provided . . . [it] is properly apportioned to local activities within the taxing State forming sufficient nexus to support the same" (358 US 450, 452 [1959]). [****9] The "rather limited" purpose of Public Law 86-272 was to set a "lower limit" on state taxation (*Heublein, Inc. v South Carolina Tax Comm'n*, 409 US 275, 279, 280 [1972]), to establish a "'minimum standard' for imposition of a state net-income tax based on solicitation of interstate sales" (*Wisconsin Dept. of Revenue v William Wrigley, Jr., Co.*, 505 US 214, 222 [1992]). Congressional concern was for small- and medium-sized businesses that might have to file a return in every state where they solicited a sales order. In the words of the House Report on the proposed bill:

"compliance with the diverse tax laws of every jurisdiction in which income is produced will require the maintenance of records for each jurisdiction and the retention of legal counsel and accountants who are familiar with the tax practice of each jurisdiction. This will mean increases in overhead charges, in some cases to an extent that will make it uneconomical for a small business to sell at all in areas where volume is small" (HR Rep 936, 86th Cong, 1st Sess; see *Matter of Gillette Co. v State Tax Commn.*, 56 AD2d 475, 481 [3d Dept 1977], *affd* 45 NY2d 846 [1978]).

Congressman William E. Miller (New York) explained:

"[T]his legislation is not broad in its effect. It is very narrow, indeed. It covers only the single and simple area where a corporation does nothing more within a State than solicit orders. . . . This is important to small business. Large corporations can afford the attorneys and the accountants necessary to keep books for the payment of some 34 different State taxes computed on 34 different State taxing provisions. But, small business engaged in interstate commerce who do nothing more, perhaps than solicit orders either by a salesman within a State or even just through the mail, have always thought that they would not be subject to multiple State taxation" (105 Cong Rec 17771 [1959]).

Both formula apportionment schemes and unitary reporting existed at the time the statute was enacted (see e. g. L 1944, ch 415), [*405] and nothing in the bill's history suggests that Congress intended to alter the use or applicability of these methods. In fact, the bill was originally intended as a temporary, or stopgap, measure until congressional committees were able to study the "entire problem of state taxation of interstate commerce" (*Heublein*, 409 US at 281; see 1959 US Code Cong & Admin News, at 2559). Congress, however, has declined to further address the question since the statute was enacted, notwithstanding the struggles the provision generated in California, as the following discussion reflects. [**96] [***1038]

Disney's synergies date back to the earliest years of the company, in the 1920s. The company itself says that it continues to expand its market segments, comprised of "integrated, well-connected businesses that operate in concert to maximize exposure and growth worldwide." This is a far cry from the limited objective of Public Law 86-272. We cannot agree that the statute was intended to prevent inclusion of New York income generated by the unified activities of this corporate giant in the state's franchise tax apportionment scheme.

C. The California Experience

In reaching our conclusions, we have considered the helpful [****10] insights of the California tax courts, which, along with that state's Court of Appeal, have conducted the most thorough analysis of this issue (albeit in large part with relation to application of California's "throw back" rule, [fn6] which we do not have in New York). Although ultimately deciding to prohibit inclusion of income such as Video's in the numerator of apportionment formulas with respect to combined groups, California did so as a matter of tax policy, finding no "legal flaws" in either formula.

In 1966, the California State Board of Equalization (SBE) adopted what is now referred to as the "Joyce rule." The activities of U.S. Shoe, a company that had acquired Joyce, Inc., were limited to visits by sales representatives who solicited but did [*406] not accept orders from merchants (*Matter of Joyce, Inc.*, 1966 Cal Tax LEXIS 18, *2-3). The California Franchise Tax Board deemed that Joyce and Shoe were engaged in a unitary business and combined the two companies' income for apportionment purposes. The SBE held that pursuant to Public Law 86-272 "no state has the power to impose a tax on or measured by income derived within the state by any person if the only business activities within the state are the solicitation of orders for sales," thus "the net income of U.S. Shoe derived from sources within this state was not includible" in the formula (*id.* at *9, 10).

In 1988, the California SBE changed course. In *Matter of Finnigan Corp.* (1988 Cal Tax LEXIS 28), it adopted what is now referred to as the "Finnigan rule." California's "throw back" rule, modeled after a Uniform Division of Income for Tax Purposes Act (UDITPA) provision, required that sales not taxable in the state of the destination of the goods by operation of Public Law 86-272 be assigned back to California if the property was shipped from California. The California Franchise Tax Board would "throw back" these sales regardless of whether the company reported its income in the destination state as part of a unitary group of which other members were taxable. Finnigan maintained

that for purposes of consistency, the word "taxpayer," used in the throw back provision, must mean all of the corporations in the unitary group.

The SBE agreed. It noted that "[t]o hold otherwise would result in an apportionment formula which produced a different tax effect where the unitary business was conducted by the divisions of a single corporation than where it was conducted by multiple corporations. No difference in **[**97] [***1039]** principle is discernible in the two situations" (*id.* at *7). On petition for rehearing, the SBE overruled *Matter of Joyce*, declaring that "Joyce established an unsound rule of apportionment out of fear that the courts would give an expansive interpretation to Public Law No. 86-272 and thereby seriously restrict the application of unitary apportionment principles to multicorporate businesses" (*1990 Cal Tax LEXIS 4*, *5). This fear having been shown to be unfounded, the SBE considered the latitude granted to states' apportionment formulas in *Container Corp.* and recent scholarly criticism of *Joyce*. It concluded that:

"Joyce undeniably contravenes fundamental unitary theory in two important respects. **[****11]** First, by **[*407]** forbidding the assignment of sales to the state of destination in situations where at least one member of the unitary group is taxable in that state, but the actual seller is not, the Joyce rule defeats the basic purpose of the sales factor, which is to reflect the markets for the unitary business's goods and services" (*id.* at *3).

In 1999, however, the California SBE again reversed course. In order to promote uniformity under UDITPA, it decided to apply the *Joyce* rule prospectively (see *Matter of Huffly Corp.*, *1999 Cal Tax Lexis 173*). It based its decision on the application of the throw back rule, which resulted in two scenarios: "California-based sellers who sell into other states where they are immune from tax as individual corporations will not be subject to tax in any jurisdiction" and "[n]on-California based sellers who sell into California where they are immune but their sister entities are taxable will run the risk of . . . double taxation" (*Matter of Huffly Corp.*, *1999 Cal Tax LEXIS 173*, *10). The SBE concluded "[w]hile there were theoretically good reasons for the . . . implementation of the . . . rule," in light of the scenarios above and "to promote uniformity of the UDITPA law" *Joyce* was the "better law" (*id.* at *11).

California courts have since defended the *Finnigan* rule from Public Law 86-272 attack, finding no violation as the apportionment did not amount to a tax (see *Deluxe Corp. v Franchise Tax Bd.*, No. 403-204 [Cal Ct App 2001] ["By applying principles of combined reporting and formula apportionment, California seeks only to determine the income attributable to California generated by members of (the) unitary group. . . . (B)y applying the *Finnigan* methodology, California does not seek to tax any individual member of (the) unitary group not otherwise subject to tax in the state"]). Thus, the courts analyzing pre-*Huffly* and post-*Huffly* tax assessments have determined that either method was legally acceptable (see *Citicorp N. Am., Inc. v Franchise Tax Bd.*, 83 Cal App 4th 1403, 1421, 100 Cal Rep 2d 509, 524 [2000] ["the SBE returned to the *Joyce* rule without finding legal flaws in the *Finnigan* rule"]).**[fn7] [*408]**

That the *Joyce* rule is recommended **[**98] [***1040]** by the Multistate Tax Commission^[fn8] in furtherance of consistency under UDITPA, while a valid consideration from a policy perspective, lacks relevance to the preemptive scope of Public Law 86-272. New York has not adopted the Model Act, and "the mere fact that other bodies and jurisdictions did not follow the *Finnigan* rule is not a valid basis for this court to disregard the considered decision of a constitutionally created quasi-judicial administrative agency" (*Citicorp*, 83 Cal App 4th at 1418, 100 Cal Rptr 2d at 522).

While choosing the "better" law is not a role we assume here, we note that compelling policies underlie the result we reach. Not to include in the apportionment formula the receipts of entities whose in-state income may well be, in some hard-to-determine part, the result of synergistic relationships with their sister companies would permit corporate groups to avoid taxes by moving income to such entities from other members of the group. While the rule may not benefit companies based in states with throw back rules that follow *Joyce*, the role of the Legislature is to weigh these **[****12]** considerations in selecting a formula. "In the absence of a central coordinating authority, absolute consistency . . . may just be too much to ask" (*Container Corp.*, 463 US at 192).

D. Constitutional Claims

Finally, Disney's constitutional claims are without merit. The "Constitution imposes no single formula on the States" but merely requires a "'minimal connection' or 'nexus' between the interstate activities and the taxing State, and 'a rational relationship between the income attributed to the State and the intrastate values of the enterprise'" (see *id.* at 164, 165-166, quoting *Exxon Corp. v Department of Revenue of Wis.*, 447 US 207, 219-220 [1980]). A tax, further, will not survive Commerce Clause scrutiny if petitioner shows that it (1) applies to an activity lacking a substantial nexus to the taxing state; (2) is not fairly apportioned; (3) discriminates [*409] against interstate commerce; or (4) is not fairly related to the services provided by the state (*Complete Auto Transit, Inc. v Brady*, 430 US 274, 279 [1977]). The tax imposed on the Disney group is not grossly disproportionate to its New York activities, and is both fairly apportioned and nondiscriminatory.

Accordingly, the judgment of the Appellate Division should be affirmed, with costs.

[fn1] The Tax Commissioner is given the sole discretion to grant an application for combined reporting, or to require a taxpayer to file a combined report when a corporate taxpayer otherwise meets the stock ownership or control criteria for combined reporting (see Tax Law § 211 [4] [a]).

[fn2] The receipts factor is double-weighted under New York's formula (see Tax Law § 210 [3] [a] [4]).

[fn3] Disney concedes that Video should have been included in the combined group for each of tax years 1990-1992.

[fn4] *Section 102* (codified as 15 USC § 382) prohibits later assessment of taxes if imposition was otherwise prohibited by *section 101*.

[fn5] The *Shell Oil* Court noted, with regard to inclusion of extraterritorial sales in the preapportioned tax base, that

"[a]ctual sales . . . are not taxed directly by any State because they are not included in the numerator of the sales ratio. From the inclusion of such sales in the apportionment formula's tax base, it does not follow that the dollar amount derived from the formula (which is a fraction of the unitary tax base) includes income not fairly attributable to Iowa" (488 US at 31 [citation omitted]).

As Video's income is fairly attributable to New York sales, we are satisfied that our decision comports with the principles underlying *Shell Oil*.

[fn6] California Revenue & Taxation Code § 25122 provides:

"[f]or purposes of allocation and apportionment of income under this act, a taxpayer is taxable in another state if (a) in that state it is subject to a net income tax, a franchise tax measured by net income, a franchise tax for the privilege of doing business, or a corporate stock tax, or (b) that state has jurisdiction to subject the taxpayer to a net income tax regardless of whether, in fact, the state does or does not."

[fn7] States, and courts, have split on which rule to follow, although the majority (and those states adopting UDITPA) follow *Joyce* (see *Emerson Elec. Co. v Wasson*, 287 SC 394, 339 SE2d 118 [1986] ["taxpayer" an independently taxable entity pursuant to state's throw back rule]; *Dover Corp. v Department of Revenue*, 271 111 App 3d 700, 648 NE2d 1089 [1995] [same]; *Great N. Nekoosa Corp. v State Tax Assessor*, 675 A2d 963 [Me 1996] [same]; *but see Airborne Nav., 1987 Ariz Tax LEXIS 34* [adopting rule of *Finnigan*]; *see also Kan Rev Rul 12-91-1* [adopting rule of *Finnigan*]; Utah Admin Code rule 865-6F-24 [same]; Ind Dept of Rev Tax Policy Directive No. 6 [1992] [adopting *Finnigan* for permissive combinations]).

[fn8] The Multistate Tax Commission only has the power to issue nonbinding regulations (see State Taxation, Appendices A and B).

SMITH, J. (concurring).

I agree with the result reached by the majority, and with the reasoning in sections B, C and D of the majority opinion, which I think amply support the result. I cannot join the majority opinion in full, because section A of the majority's analysis seems to me both unnecessary to the decision and wrong.

Section A discusses whether New York is "imposing a tax" on Buena Vista Home Video (Video) by including Video's receipts in the numerator of the fraction used to determine the New York income of a consolidated group of companies. It is unnecessary to decide this question, because this case does not turn on whether New York is imposing a tax on Video. Video is a corporation that transacts business in New York, and it is not immune from New York State tax unless Public Law 86-272 (73 US Stat 555) [**99] [***1041] immunizes it — which it does not. As the majority explains in section B of its analysis, the relevant "person" for purposes of a Public Law 86-272 analysis is not Video, but the consolidated group. Having decided that, we need decide nothing more.

I find section A not just superfluous, but also wrong, because including a company's receipts in the numerator of the apportionment fraction effectively imposes a tax on that company. Suppose Video *were* immune from New York tax — suppose, for example, that Video's activities lacked the constitutionally required "minimal connection" to New York (*see Moorman Mfg. Co. v Bair*, 437 US 267, 273 [1978]). Surely New York could not, in such a case, include Video's receipts in the numerator. To do so would be to increase the tax in proportion to those receipts — and thus in substance to tax the income associated with those receipts (*see Shell Oil Co. v Iowa Dept. of Revenue*, 488 US 19, 31 [1988] [sales held not taxed "because they are not included in the numerator of the sales ratio"]). The majority cites no authority suggesting otherwise. [*410]

Judgment affirmed, with costs.

General Information

Judge(s)	J. Smith; Kaye
Topic(s)	Tax & Accounting
Parties	In the Matter of DISNEY ENTERPRISES, INC., et al., Appellants, v. TAX APPEALS TRIBUNAL OF THE STATE OF NEW YORK et al., Respondents.
Case Type	BV
Court	New York Court of Appeals

Matter of Disney Enter., Inc. v. Tax Appeals Trib., 10 N.Y.3d 392, 859 N.Y.S.2d 87, 888 N.E.2d 1029 (2008), Court Opinion

Direct History

- 1  **Matter of Disney Enter., Inc. v. Tax Appeals Trib., 10 N.Y.3d 392, 859 N.Y.S.2d 87, 888 N.E.2d 1029 (2008)**
affirming the judgment in
 Matter of Disney Enters., Inc. v. Tax Appeals Trib. of New York, 40 A.D.3d 49, 830 N.Y.S.2d 614 (App Div, 3d Dept 2007)
- 2  **Matter of Disney Enters., Inc. v. Tax Appeals Trib., 9 N.Y.3d 858, 840 N.Y.S.2d 757, 872 N.E.2d 869 (2007)**
order entered, motion granted (per curiam)
- 3  **Matter of Disney Enters., Inc. v. Tax Appeals Trib. of New York, 40 A.D.3d 49, 830 N.Y.S.2d 614 (App Div, 3d Dept 2007)**
dismissing the petition and affirming the determination or finding in
Unpublished Opinion or Order

Direct History Summary		
	Caution	0
	Negative	0
Total		0

Case Analysis Summary		
	Positive	7
	Distinguished	0
	Caution	0
	Superseded	0
	Negative	0
Total		7

Case Analysis (7 cases)

- 1   Cited in  Tesoro Corp. & Subsidiaries v. Alaska, Dep't of Revenue, 312 P.3d 830 (Alaska 2013)
- 2   Cited in , Quoted  Sec. Investor Prot. Corp. v. Bernard L. Madoff Inv. Sec. LLC, 491 B.R. 27 (S.D.N.Y. 2013)
- 3   Cited in  Matter of Meredith Corp. v. Tax Appeals Trib. of Dept. of Taxation & Fin. of State, 102 A.D.3d 156, 956 N.Y.S.2d 585 (App Div, 3d Dept 2012)
- 4   Discussed in , (See generally) , Quoted  New York State Assn. of Enrolled Agents, Inc. v. New York State Dept. of Taxation & Fin., 29 Misc. 3d 332, 905 N.Y.S.2d 856 (Sup. Ct. 2010)
- 5   Discussed in , Quoted  Arizona Dept. of Revenue v. Central Newspapers, Inc., 222 Ariz. 626, 218 P.3d 1083 (App. Div. 1 2009)

Case Analysis (7 cases)

- 6   Cited in , (See)  Matter of Nathan v. Commr. of taxation & Fin.,
64 A.D.3d 1055, 883 N.Y.S.2d 367 (App Div,
3d Dept 2009)
- 7   Cited in , Quoted  Pfizer Inc. v. Dir., Div. of Taxation, 24 N.J.
Tax 116 (Tax Ct. 2008)